2015 State Of The Industry:

Aviation

With a respite in fuel prices, the International Air Transport Association (IATA) is forecasting global profits for the airline industry of $25 billion in 2015*. Regardless, L.E.K. sees the next five years as critical for individual airlines to carve out a sustainable competitive position. Additionally, there are specific markets such as Brazil and India where destructive overcapacity persists that continues to destabilize all players.

What are the Biggest Challenges and Opportunities Facing the Airline and Aviation Industries this Year?

While each carrier will face its own unique set of challenges, we see three that transcend the industry:

1. **Securing the right joint venture partners.** With ever increasing open skies and antitrust immunity (ATI), airlines are securing long-term joint venture (JV) partners that, given metal neutrality, dramatically improve the economics (and competitiveness) of the JV partners on their routes. However, there is a limited set of JV partners. Unlike alliances, once these JVs are set, they will be in place for at least 5-10 years, hence putting non-JV partners at a structural disadvantage for the next decade. And selecting the right partner is key – full economic benefit will only accrue if your customers perceive it to be a seamless offering.

2. **Evolving business model.** Based on our 25+ years of experience advising the airline industry, we have observed the industry coalescing around three distinct business models: ultra low cost carriers (ULCCs), hybrid carriers and full-service carriers (FSC). An airline can be successful in any of the three models – the model per se is not the determinant of success. However, there are distinct strategies to pursue in each model and carriers need to determine the right model for themselves and what specific strategies they need to pursue in order to be financially successful in their chosen model.

3. **Single view of the customer.** The introduction of ancillary revenues, while highly lucrative to those carriers that have pursued them, has further complicated the airlines' view of its customers and how they can deliver consistent and impactful messages to those customers. For instance, an airline's customers can be separately engaged with their frequent flyer program, e-commerce (for ancillary revenue offerings), airports (e.g., through airport-based programs), onboard (through customer satisfaction surveys), baggage services, etc. And each of these functional silos will have different ways of dealing with the same customer. Ultimately, there is no single unifying function at the airline that owns the customer. In a recent survey by one of the leading technology providers to the industry, only 3% of airlines claimed to have a single view of the customer, yet 28% said it was one of their key initiatives, acknowledging that the old way of multiple points of interaction with their customers was ineffectual, and worse still, alienating their most important and valuable customers.

What's the Current State of the Industry?

We see four developments with important implications:

1. Lower fuel prices for 2015 translates into a 10-15% drop in overall operating costs from 2014 and will mask any relative underperformance in 2015, while also providing an opening for some carriers to make aggressive investments to strengthen their core activities.

* Forecast assumes 2015 full-year average price of $85/barrel (trading at $55/barrel as of Dec. 31. 2014).

2. Further encroachment on traditional markets by the Middle Eastern carriers occurring as they build up the spokes to their Middle Eastern hubs, thereby further stimulating the market through better connectivity.

3. Further advances by both the ULCC and hybrid carriers into the business traveler market. Hybrid carriers, in particular, should make headway through product offerings (such as premium economy products with their associated benefits) that resonate with these travelers. This is a major issue in markets, such as Europe, where FSCs have traditionally relied on short-haul flying to cement overall high customer loyalty for business travelers. Given the difficulty to adequately differentiate on short-haul flying and their inherently higher-cost structures, FSCs are likely to struggle in these markets. What is the full range of alternatives they have available and what is the real value of defending this franchise?

4. While the growing importance of immunized joint ventures does diminish the role and competitive positioning of alliances, one could argue, for example, that the Qantas/Emirates (QF/EK) joint venture has marginalized the role of Oneworld in the Australian market.

What Burning Issues are Senior Executives Facing?

The stakes have never been higher for personalizing the travel experience. Many U.S. carriers are working to catch up to their international competitors by continuing to invest in infrastructure that will lay a foundation to truly evolve their offerings in the years ahead. Merchandising will continue to lift carriers' revenues and underpin their financials, and airlines that don't get their ancillary revenue programs on target are vulnerable to losing sales and customers.

Our Aviation Practice

L.E.K. Consulting works with the world's leading airlines, airports and travel & tourism companies to enhance strategic and business performance, which increases shareholder value. We combine deep industry knowledge with rigorous analysis to provide clients with the insights required to make confident, fact-based decisions amid market uncertainty.

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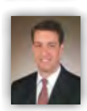

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