



## Behind the Curtain: How Top Airlines Achieve and Maintain Success

Few airlines lay claim to being consistently and highly profitable, but those that do share a number of key traits. In the first of a multipart *Executive Insights* series, L.E.K. Consulting's John Thomas and Spencer Stuart's Michael Bell and Thierry Lindenau examine how the industry's top players have achieved and maintained their success.

How does one become a millionaire in the airline industry? Start as a billionaire. This old adage, however cynical, holds an element of truth in that until only recently, the cumulative profit of the global airline industry, since its birth more than 100 years ago, was actually negative.

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For good reason, the investor community, in general, has been wary of the airline sector. The industry effectively operates with an immune deficiency syndrome in that it is susceptible to many

exogenous shocks — terrorism, severe weather, health epidemics, economic cycles, etc. — and has little in the way of defenses against them. With few exceptions, such as those pilots fortunate enough to have received stock when they joined Southwest Airlines in the early 1970s, the industry has struggled to deliver attractive economic returns.

Rays of hope have begun to shine over the past few years as airlines from around the globe are posting record revenues and profits, and it would appear that industry consolidation, capacity control, business model convergence, product unbundling/ ancillary revenues and clever revenue management have finally combined to put the industry in a position for sustained attractive earnings.

A handful of airlines have served as notable exceptions, delivering attractive — and for the most part, consistent — financial results to their shareholders. As measured by total economic profit over the 2009-2013 time period, the top 10 carriers around the globe are Delta Air Lines, United Airlines, Emirates, Ryanair, Copa Airlines, Alaska Airlines, WestJet, Japan Airlines, US Airways (pre-merger) and Southwest Airlines. Economic return — defined as the surplus the company generates after charging for the capital that it employs at its relevant cost of capital rate — is the most robust measure of true shareholder value delivery.

The following carriers are notable examples that have charted a clear path to financial success:

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*Behind the Curtain: How Top Airlines Achieve and Maintain Success* was written by **John Thomas**, Managing Director and Head of L.E.K. Consulting's global Aviation practice, and **Michael Bell** and **Thierry Lindenau**, consultants within the aviation, aerospace and defense practice of executive search consulting firm Spencer Stuart.

For more information, please contact [aviation@lek.com](mailto:aviation@lek.com).

# Executive Insights

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**Copa Airlines.** Over the past two decades, Chief Executive Officer Pedro Heilbron has transformed Copa from a marginal Central American player to the dominant player in thin north-south routes within the Americas, capitalizing on its well-situated Panama City hub. It has taken its stock to the public markets and is delivering healthy double-digit revenue and profit growth year over year.

**Delta Air Lines.** Under the steady hand of Chief Executive Officer Richard Anderson, Delta Air Lines has come to lead the U.S. (and global) industry in financial returns, innovation and customer satisfaction. Having successfully integrated Northwest Airlines in a “best practice” merger after its own effective restructuring in Chapter 11 bankruptcy protection, Delta has leveraged its massive scale and network — both directly and indirectly through alliances and joint ventures — into record profits.

**Emirates.** Leveraging its powerful transcontinental hub in Dubai, Emirates has come to dominate “the high end” of the industry, providing business and leisure travelers alike with global connectivity combined with leading-edge customer service. It is the Pan Am of the new millennium, and airline President Sir Tim Clark has leveraged his massive Airbus A380 fleet to drive down unit costs so as to ensure profitability in virtually all markets.

**Ryanair.** Through its relentless pursuit of the lowest costs in the industry and translating that into rock-bottom, unbundled fares, Ryanair has become the role model ultra-low-cost carrier. In so doing, Chief Executive Officer Michael O’Leary has delivered highly consistent healthy profits to shareholders while turning Ryanair into the most popular airline in Europe. And the airline has recently adopted a “kinder and gentler” positioning, delivering its no-frills service with a smile and catering more to business travelers.

**WestJet.** From its humble roots as a regional player in Western Canada, WestJet has morphed into the model “hybrid” carrier, maintaining key elements of the low-cost carrier model while building connectivity to the rest of the industry. Under the leadership of Chief Executive Officer Gregg Saretsky, WestJet has translated its highly loyal customer base and workforce into record profits and a material share of the Canadian travel market.

## Five universal truths behind high-achiever performance

This multipart *Executive Insights* series looks “behind the curtain” at what these companies and other financial standouts in the industry are doing to deliver outstanding shareholder returns. In subsequent installments of this series, we will profile each of these five remarkable carriers and share our perspectives on what they are doing right, as well as those of the airline leaders

themselves. While the true “golden nuggets” come in the form of specific actions taken by individual carriers, our study to date points to five universal truths that underlie the performance of each of these high-achiever airlines:

- 1. Strategic focus and clarity.** These airlines know what business they are in. They have clear and differentiated business models and deliver a compelling value proposition to their customers. There is no ambiguity about their business model and they don’t change it every other year.
- 2. Cost discipline.** Regardless of their business model, all the high performers keep a sharp focus on unit cost and spend money wisely. For those in the ultra-low-fare arena, doing so is a necessity; for those in higher-yielding segments, it ensures profitability.
- 3. Bold, industry-changing actions.** Each of these high performers has been aggressive in the pursuit of its business model and in changing the industry in its favor; they are keen and bold competitors, eager to win. The highest-performing airlines are also ahead of the curve, whether in identifying and pursuing new markets or implementing product and service innovations.
- 4. Stable and visionary leadership.** At the helm of each of these high performers is a strong and visionary leader who has assembled a fairly stable, yet evolving, leadership team. In almost every case, the chief executive has been with their organization for some time and has assembled a tight-knit group of deputies who work very well together on advancing the business.
- 5. Organizational alignment.** All the key elements of their organizations — culture, structure, processes, systems, employee value proposition and incentives — are designed to support and reinforce the airline’s chosen strategic positioning. From the boardroom to the front line, individuals in the organization know what is expected of them and how their specific roles contribute to delivering on the strategy.

Interestingly, no single airline business model dominates the top-performer list and the spread is very wide, from the premium first-class cabins of Emirates to the bare-bones offering of Ryanair. The implication is that success depends not on what business segment you are in, but rather on excelling in whatever business segment you choose to compete in and being true to your chosen model over time. This commitment is particularly vital in the era of airline business model convergence, with the blurring of the traditional lines that historically separated low-fare from full-service carriers.

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The past decade has also witnessed the emergence of the hybrid business model for airlines, incorporating the best elements of both ends of the spectrum. We estimate that hybrid carriers now command 20%-40% of most geographic markets.

With the historical boundaries between industry segments eroding, carriers are finding themselves competing with new foes. As a result, it is becoming even more important for airlines to adopt and adhere to the fundamental principles that drive strong and consistent financial performance. Future installments in this multipart series will go “behind the curtain” to see how these principles come to life.

**Editor's Note:** *Behind the Curtain: How Top Airlines Achieve and Maintain Success* was originally published in *Airline Business* in May 2015.

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## About L.E.K. Consulting

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and rigorous analysis to help business leaders achieve practical results with real impact. We are uncompromising in our approach to helping clients consistently make better decisions, deliver improved business performance and create greater shareholder returns. The firm advises and supports global companies that are leaders in their industries — including the largest private and public sector organizations, private equity firms and emerging entrepreneurial businesses. Founded more than 30 years ago, L.E.K. employs more than 1,200 professionals across the Americas, Asia-Pacific and Europe. For more information, go to [www.lek.com](http://www.lek.com).

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