



KEY POLICY ISSUE

AUGUST 2008

NEW BUSINESS MODELS TO MAKE AIRLINES MORE STRATEGIC AND AGILE

**PROFESSOR NAWAL K. TANEJA¹,
OHIO STATE UNIVERSITY**

Noted futurists are envisioning a world of consumers, suppliers, and societies that will be radically different from the past. Consider China and India as examples of two fast developing markets. They are becoming integral components of the global supply chain. The size of their middle classes is growing substantially to create huge markets for consumption, including increasing the demand for fuel. Will the radically different world call for new models to conduct business? A few companies say yes, and they have been adapting rapidly. Li & Fung, a Hong Kong-based company is producing over 8 billion dollars in garments and other products without owning a single factory.²

In the case of the airlines, the following game-changing forces, individually and collectively, mean that the industry faces “step phase changes.”

- emergence of not only higher prices for fuel, but also much greater volatility
- rising expectations of passengers relating to transparency, experience, innovation, interaction, and customization based partly on their changing lifestyles and partly on the availability of some of these product/service attributes from other industries
- further liberalization in key aviation markets, for example, a fast resolution of the second stage of the U.S.-E.U. agreement.
- potential emergence of format invaders within the airline industry—companies that are willing to conduct business in very different ways that customers value
- concern for climate change increasing to a level that governments take action that impact costs and operations

In the lists above and below, the emergence of format invaders represents the most serious potential threat/opportunity within the airline industry. There are plenty of areas where format invaders could enter the marketplace.

- There are companies looking at using very light jets (VLJ) for short-haul transportation in the form of on-demand air taxis.
- There are firms specializing in the fractional ownership of business jets who could explore the use of their resources to offer customized service to passengers and improve the utilization of their aircraft and crews with the advanced use of the Internet and innovative pricing policies.

¹ Professor and Chairman of the Department of Aviation at the Ohio State University, author of the book, *FASTEN YOUR SEATBELT: The Passenger is Flying the Plane* (2005), and forthcoming book, *Fly Ahead of the Airplane* (October 2008).

² Fung, Victor K., Fung, William K. and Yoram (Jerry) Wind *Competing in a Flat World: Building Enterprises for a Borderless World* (Upper Saddle River, NJ: Wharton School Publishing, 2008), front jacket.

- A format invader could come in with a business model that makes use of the private general aviation aircraft, again capitalizing on the use of the Internet as well as flexible and customized pricing policies.
- What if a successful global package service provider decides to operate a passenger airline in some modified form of its package business?
- What if an expert in mobile computing (for example, Apple, Blackberry, and Google) were to enter the airline business? They have the right customers (well-educated “road warriors”), the right devices, the right computing capabilities, and the know how to make use of third party hardware networks.
- What if a well-funded private equity firm found a way to get around government regulations and establish a truly global airline? Using a well-developed corporate governance and advanced IT planning systems such an airline could transcend some individual airlines, and strategic alliance partnerships.

Are these examples of the aforementioned format invaders unrealistic? Outside the airline industry, one could reflect on what the developers of word processing did to makers of type writers, or what the makers of digital cameras did to the makers of film for cameras. And what have the makers of mobile phones been doing to the makers of digital cameras since mobile phones can now take and transmit high quality photos. In the air transportation business one could look at the success of Federal Express that entered the marketplace with such a strong customer value proposition that customers were willing to pay an unthinkable price premium over the rates charges by the U.S. Postal Service for transporting documents and small packages. Ryanair has developed a business model around ultra low fares and ancillary revenue.

While a number of senior airline executives, obviously, have the foresight of potential “step phase changes,” they are struggling for insight into how to conceive new business models while simultaneously optimizing their current business models. Assuming that an airline decides to look into a new business model to adapt to the potentially radically different marketplace, what is a viable framework for developing viable business models?

- First, and in the short term, the objective should be to optimize the current business model. Typical airlines perform optimization at the functional levels. For example, the crew scheduling group acquires a more sophisticated way of scheduling crews that saves crew costs. However, the new crew scheduling system may increase delays for customers, leading to a defection of a significant percentage of premium paying passengers. Or, the finance department decides to implement an increase in the fee for making changes to reservations. Again, some premium paying business travelers may defect. What is required instead is an optimization on a systems basis or a balanced approach—balancing revenue, costs, reliability, passenger service, growth, competitive advantage, and so forth. This requirement means changing the ways costs, revenue, and customer service are managed.
- Second, management must develop a deep understanding of what current and future passengers are thinking, how their priorities are changing, and then incorporate this understanding into products and services for which passengers are willing to pay and for which airlines are able to compensate themselves adequately for their investments.
- Third, if the airline business has become a commodity business (that many airlines believe it has), then the goal is to create customer value using a different business model, exemplified by Starbucks in the U.S., Zara in Spain, Tesco in the U.K., and Cemex in Mexico. What differentiates such benchmarking companies from most airlines is that their managements change business models without compromising in areas that affect their customer value propositions.

- Fourth, management must then translate the value proposition into an emotionally appealing brand, developed around customers and employees, as well as around appropriate business concepts and processes that efficiently and flawlessly turn promises into experiences. Airline management must strategize only what they can control, and then control what they promise to deliver. Where is the evidence that a strong brand can lead to higher margins? Look at the performance of BMW and Zara in Europe. In the airline business, Singapore Airlines has not only been consistently profitable, but also obtains at least 50 percent of its revenue from first and business class passengers!³
- Fifth, management must simultaneously focus on corporate strategy for long term competitiveness (for example, strategy for brand), and the capability for short term reactions (flexibility, agility, and planning tools). Agility for “taking the curves” is what translates the horsepower of a powerful car into a race winner, and airlines need maneuvering ability more than ever. Both sharp turns and short braking distances will be required to avoid sudden obstacles: a terrorist attack, an animal disease, or a global financial crisis. Consequently, airlines need to be prepared for those appearances at any time, and they need to react immediately. This capability requires not only flexible capacities, but also planning and operations tools able to deliver results within hours. These potential changes will require management to move much more quickly, and to have a much more flexible business model. Such business models must be totally integrated and analytically driven to enable airline managements to conduct scenario analyses.

A few airline managements are clearly on the right track for developing new business models, by focusing on a customer-driven perspective, optimizing the complexity-simplicity tradeoffs, and trying to execute relentlessly current strategies while adapting to manage proactively for the future. However, based on benchmarking outside the airline industry, many airlines need to shed conventional thinking, for example, the obsession with market share. While most airline CEOs agree that the goal is profit and not market share, their actions do not support this statement. They must also overcome their historical dependence on a particular competency that may now be extremely detrimental. This is particularly relevant for some large, network carriers who have become dependent on their protected networks or alliance partnerships. Finally, airlines must not define competition too narrowly. Recall the scenario in which fractional ownership, or VLJs, or Internet-enabled travel, air-service couriers could become new competitors. If these format invaders find new ways of doing business (just as Google did with search-based advertising), then the existing airlines must not let their *perceived* core competencies blind them to new opportunities being created by the radically changing world. The alternatives are bankruptcy, shrinkage of network, government bailouts, or market presence that is irrelevant.

The views expressed in this article are the author’s and not necessarily those of IATA.

³ “Singapore Airlines: The push into China,” *Aviation Strategy*, June 2008, p. 14.