

# The economics of airline financial performance and wider economic benefits

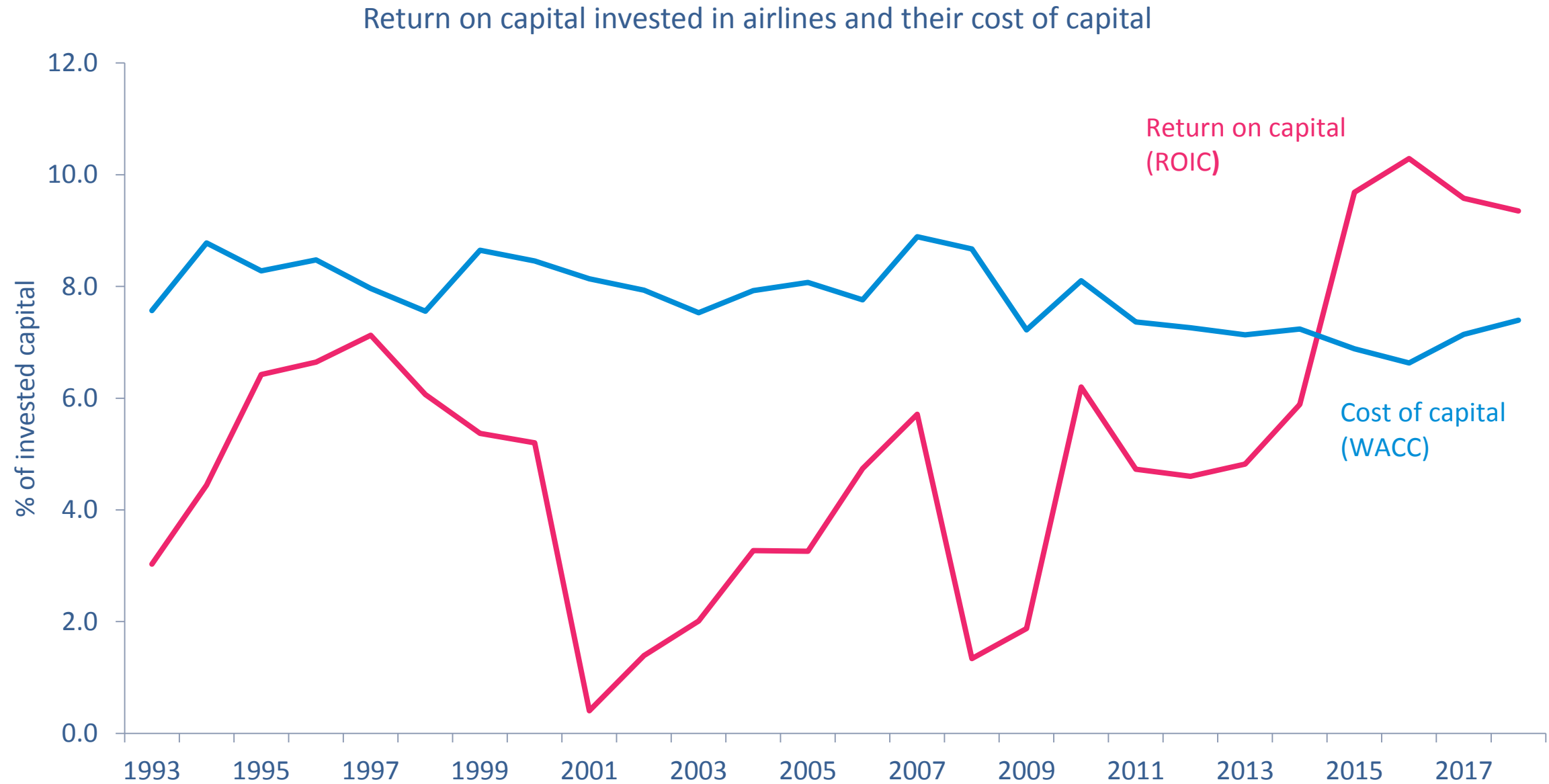
6<sup>th</sup> April 2018, Paris

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# Outline

- Why is the airline industry suddenly profitable?
  - After decades of investor capital destruction
  - Is the change widespread?
  - Have the underlying economics of the industry changed?
  - Why is the emergence of protectionism such a threat?
- How does air transport bring economic benefit?
  - Users
  - Wider economic benefits
    - Come from the people, goods, capital and ideas we carry between cities
    - Rather than the jobs required to run the service (with some exceptions)

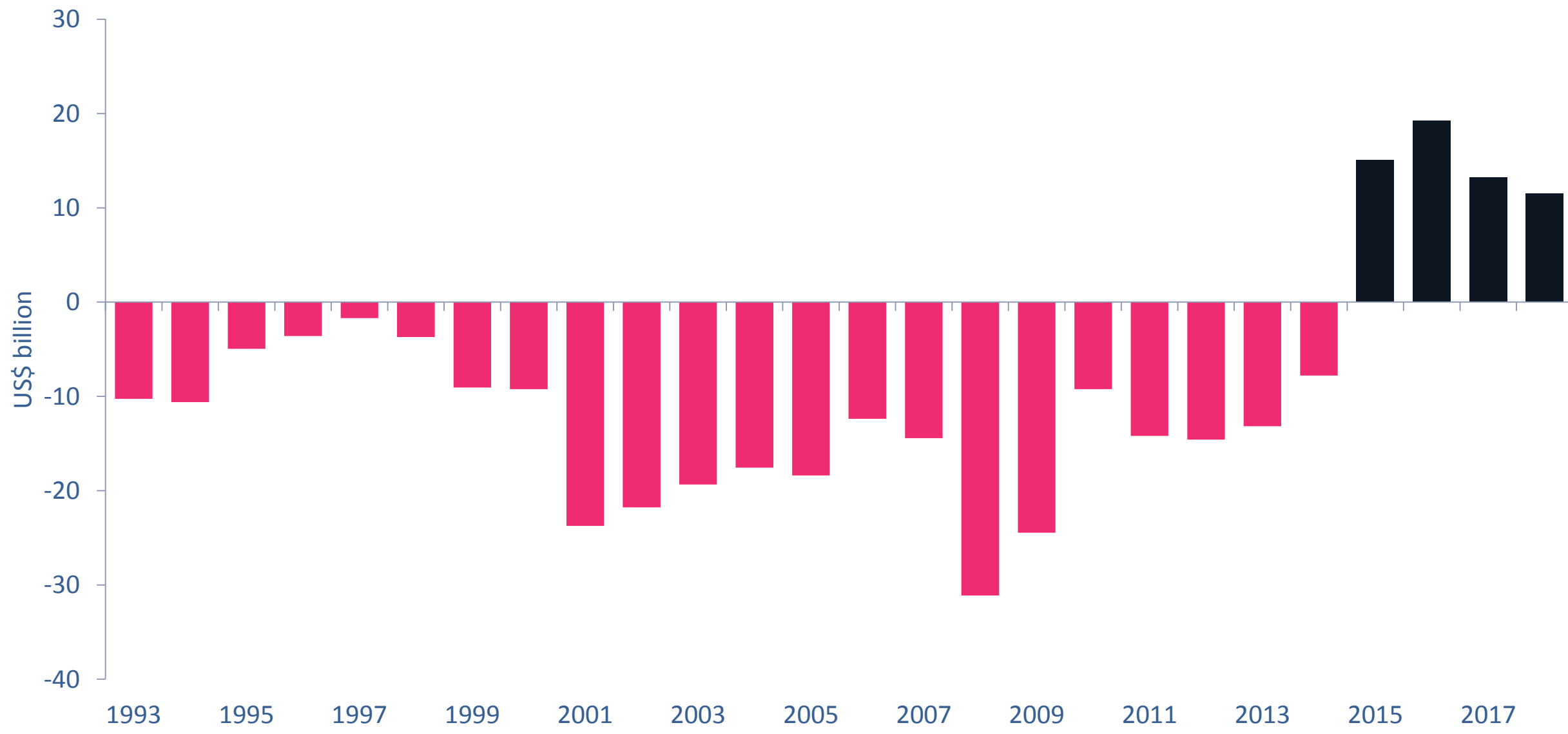
# Airlines have suddenly become profitable (for their equity investors)



Source: IATA Economics using data from McKinsey, The Airlines Analyst, IATA forecasts

# After decades of investor value destruction

Difference between investing in airlines and investing in similar assets elsewhere



Source: IATA Economics using data from McKinsey, The Airlines Analyst, IATA forecasts

# And widespread airline failures

## European LCCs



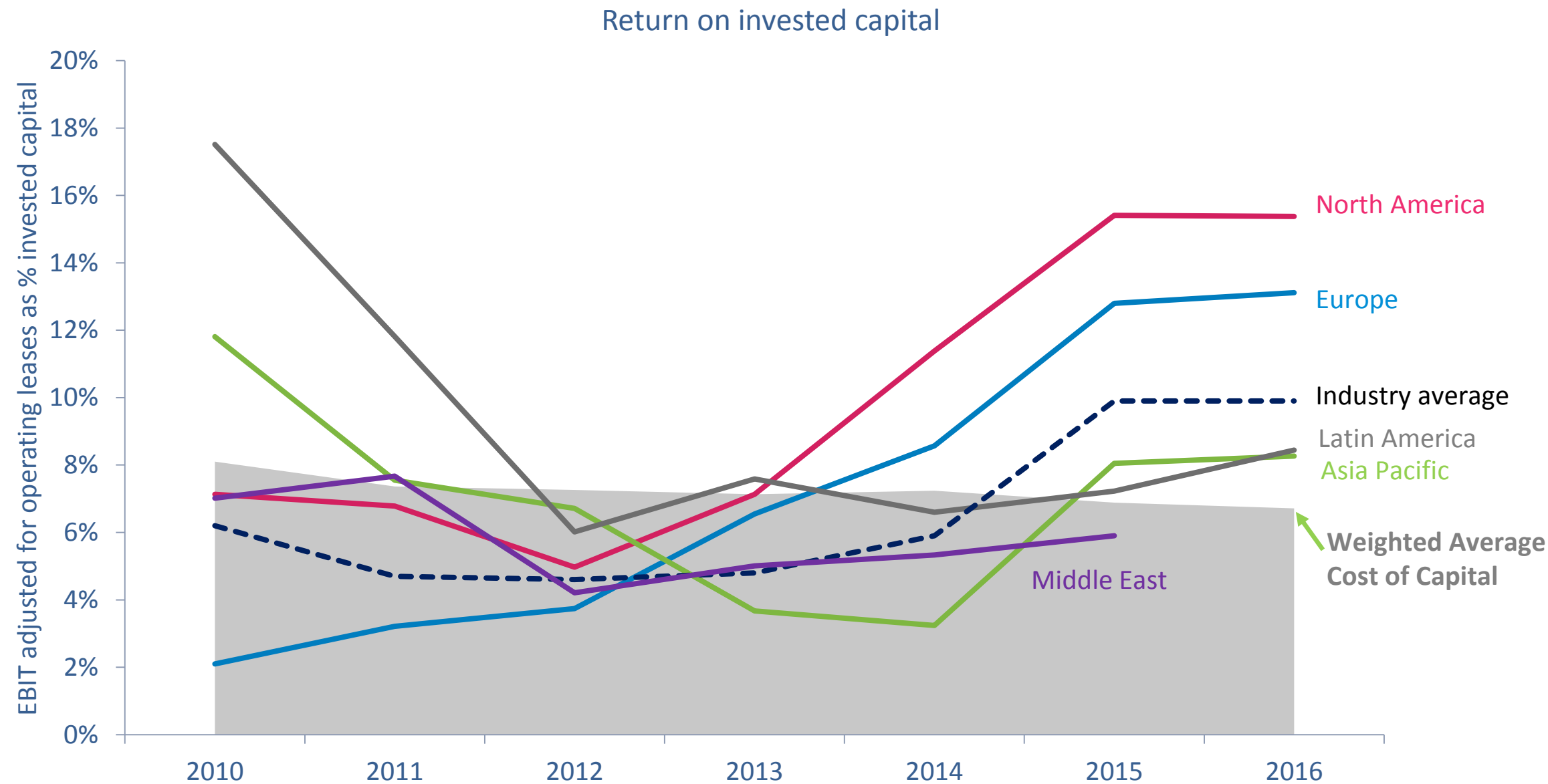
**Failed**



**Survived**

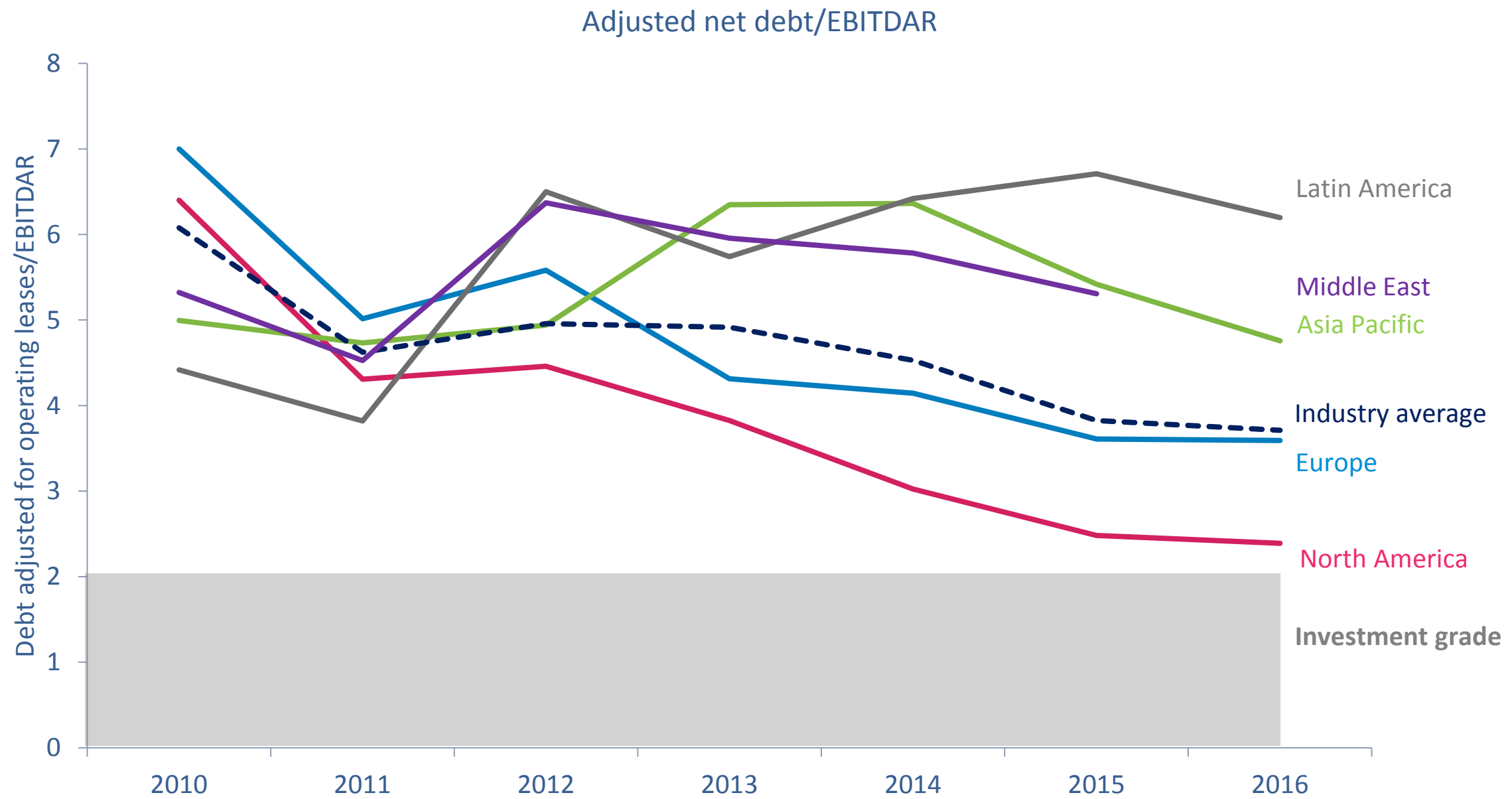
Source: HSBC report – early 2014 situation. Since then Monarch and airberlin have failed

# But improvement has been very uneven across the industry



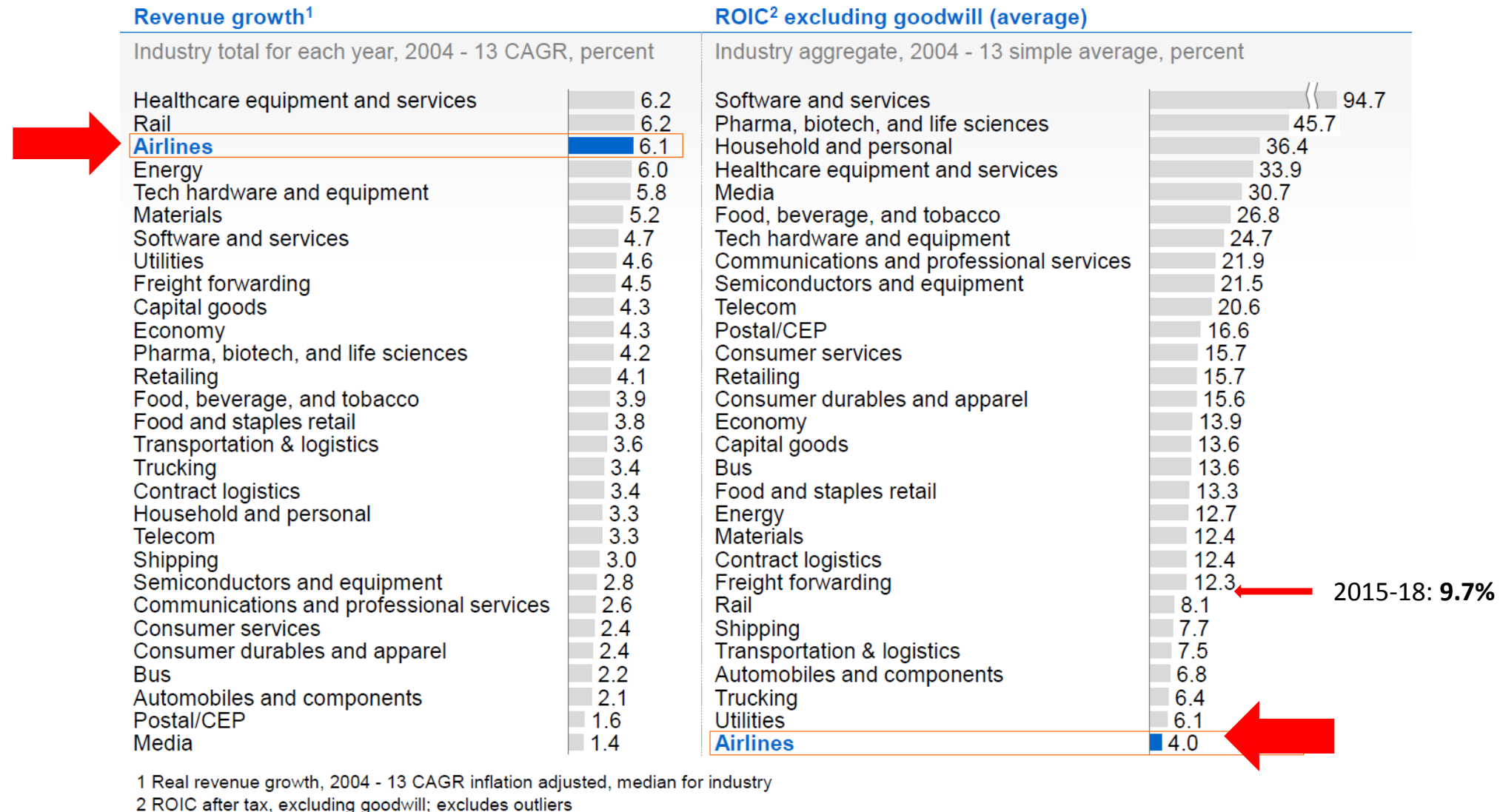
Source: IATA Economics using data from IATA and The Airline Analyst

# Balance sheet remain highly leveraged in some regions



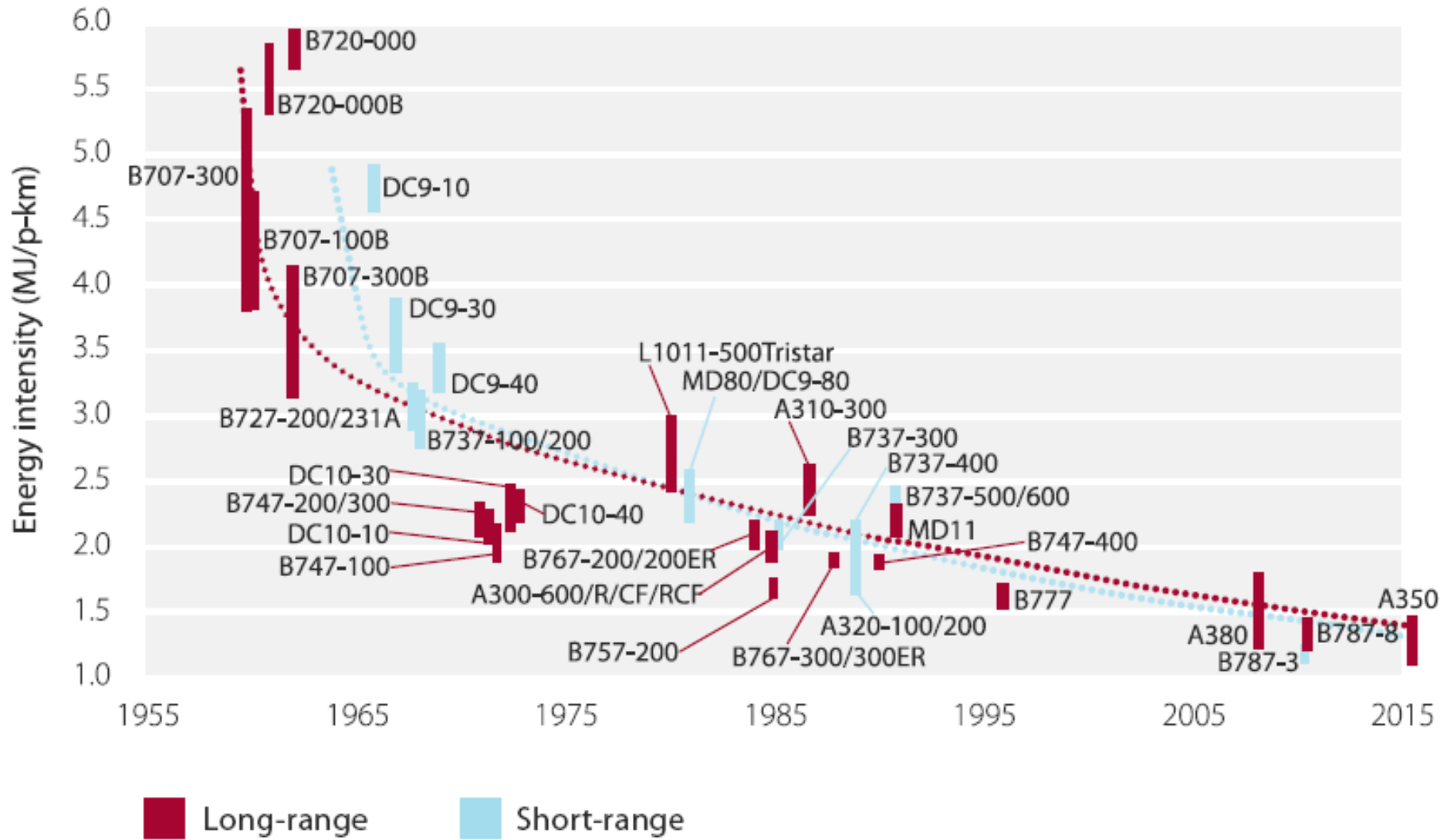
Source: IATA Economics using data from The Airline Analyst

# There has always been a paradox at the heart of air transport

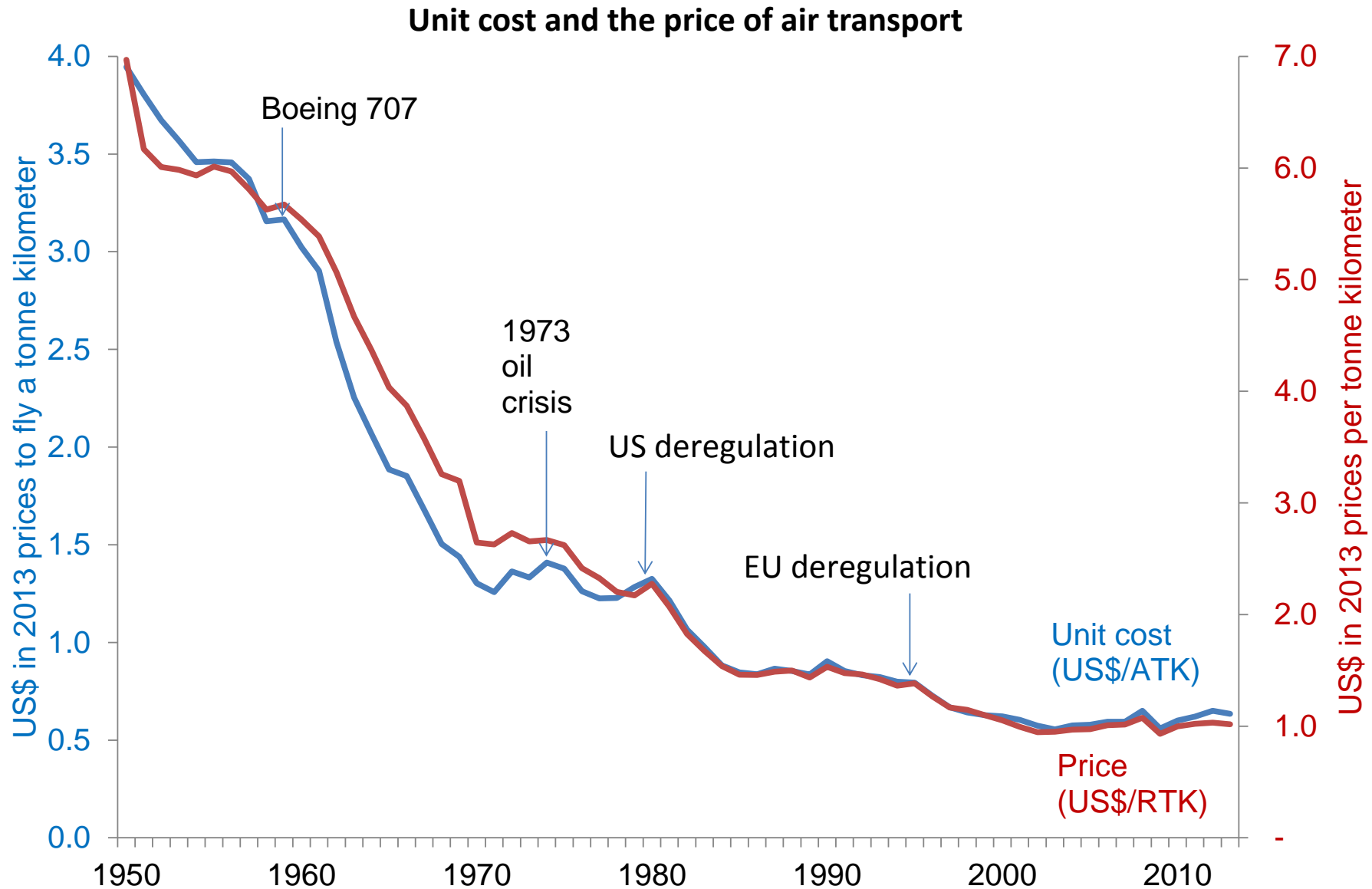




# Technology continues to cut costs dramatically

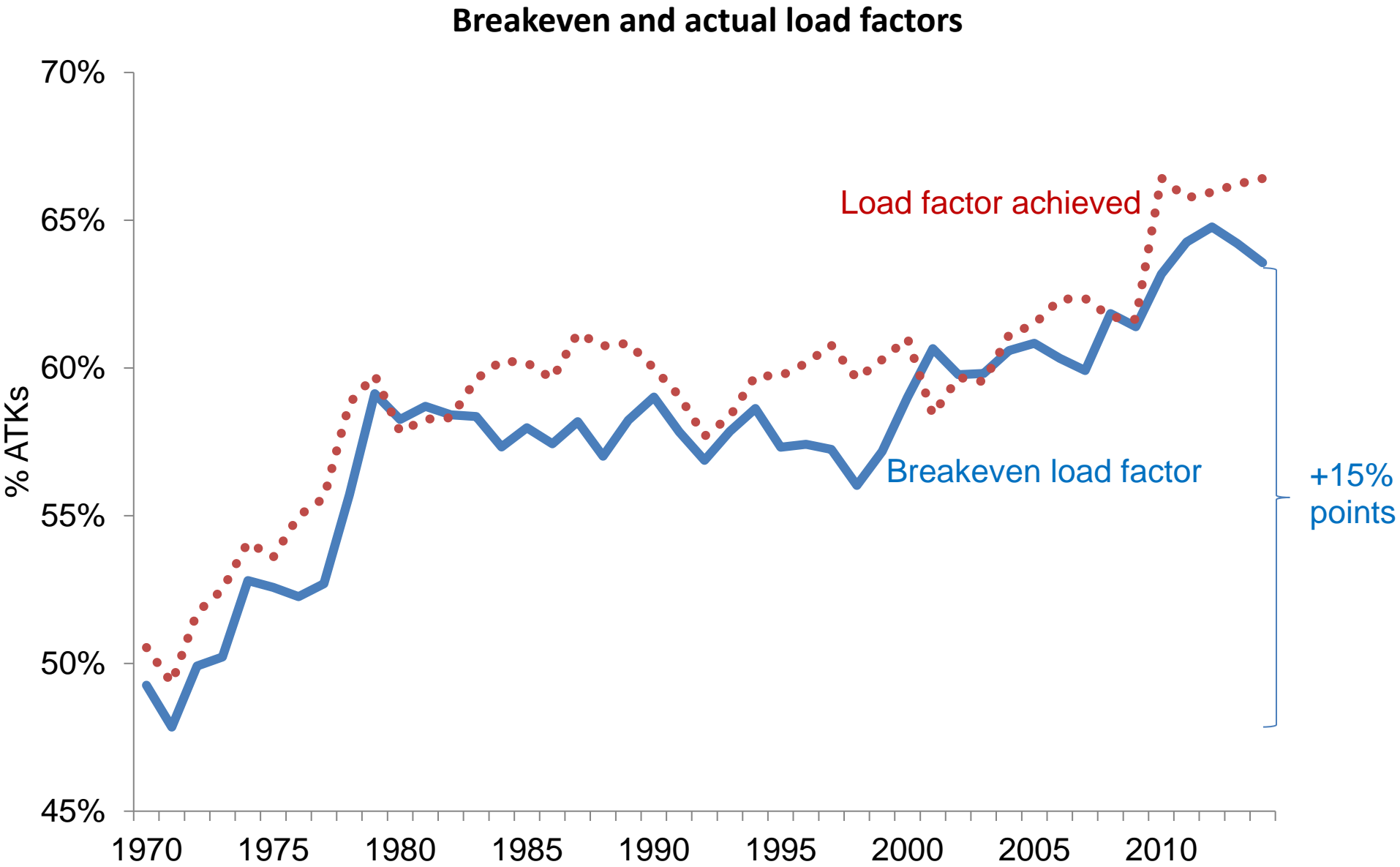


# Typically airlines pass all gains through to consumers



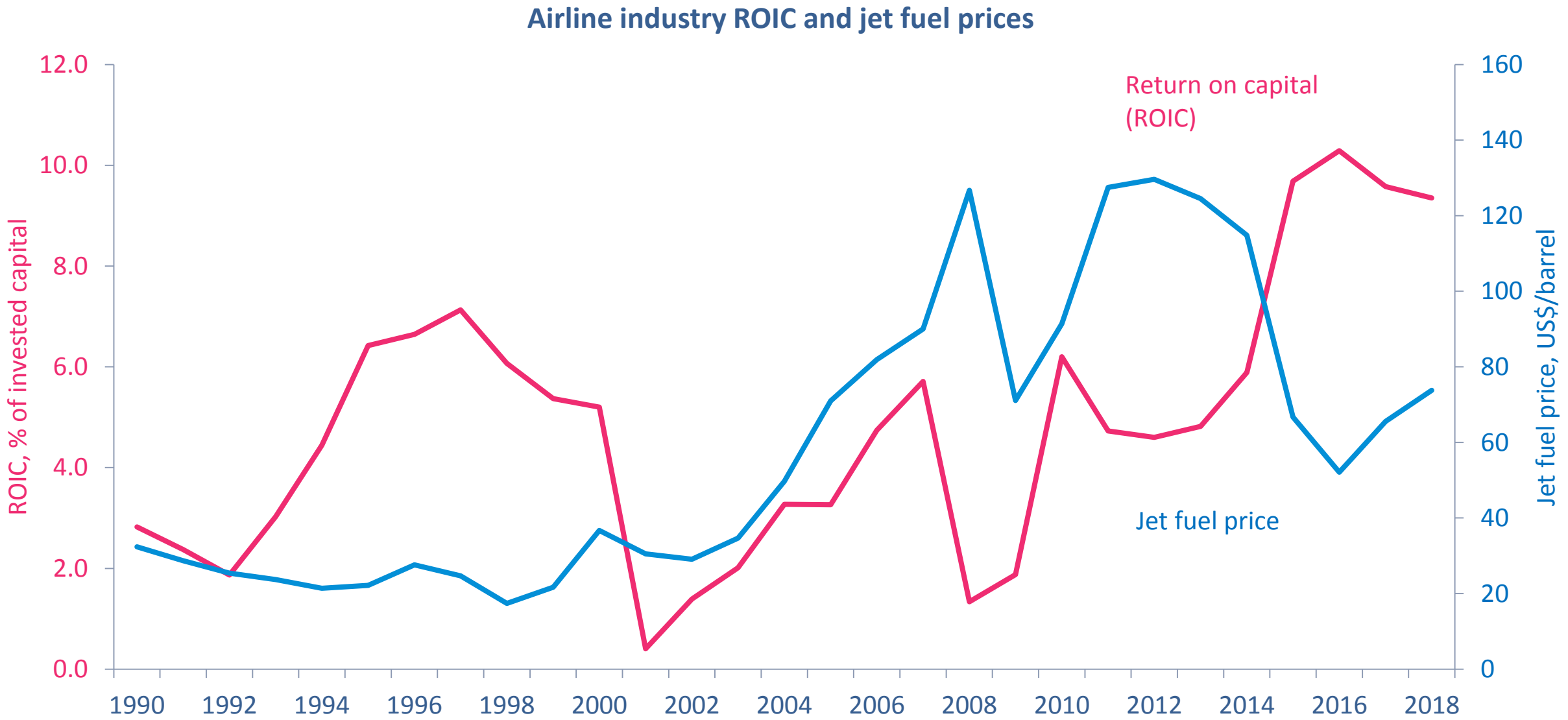
Source: IATA Economics using data from ICAO and IATA Statistics

# In fact prices have fallen further than costs forcing up breakeven loads



Source: IATA Economics using data from ICAO and IATA Statistics

# Have industry economics changed or is it just low fuel costs?



Source: IATA Economics using data from McKinsey, Platts and own forecasts

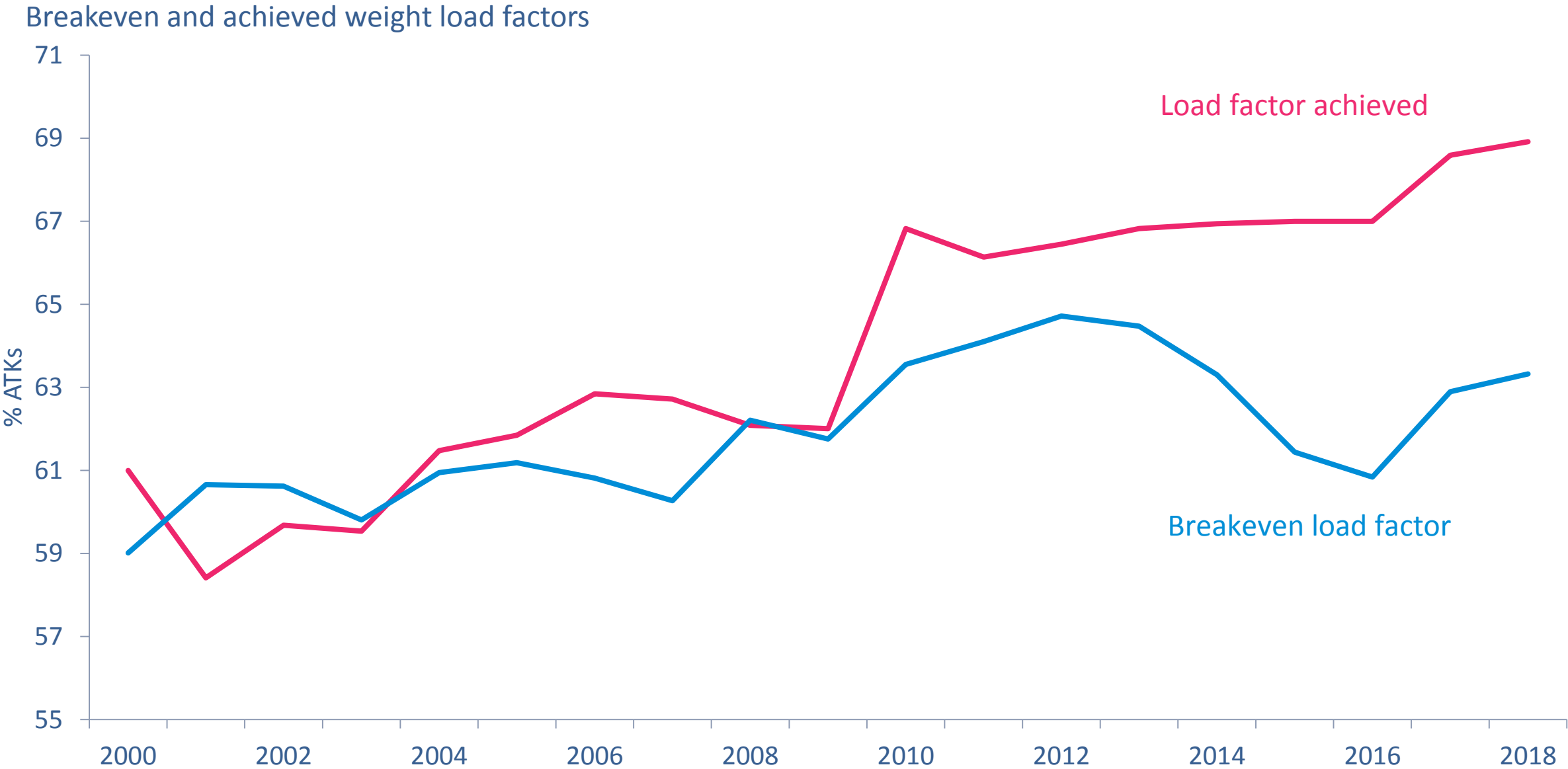
# The underlying economics of air transport

- Perishable
- Fixed costs high
- Barriers to entry low
- Competitive advantages hard to defend
- Aircraft are a platform to serve many markets
- Economies of scale in aircraft size but business travelers want frequency and flexibility
- Few scale economies in fleet size but economies of density in networks

## OUTCOME:

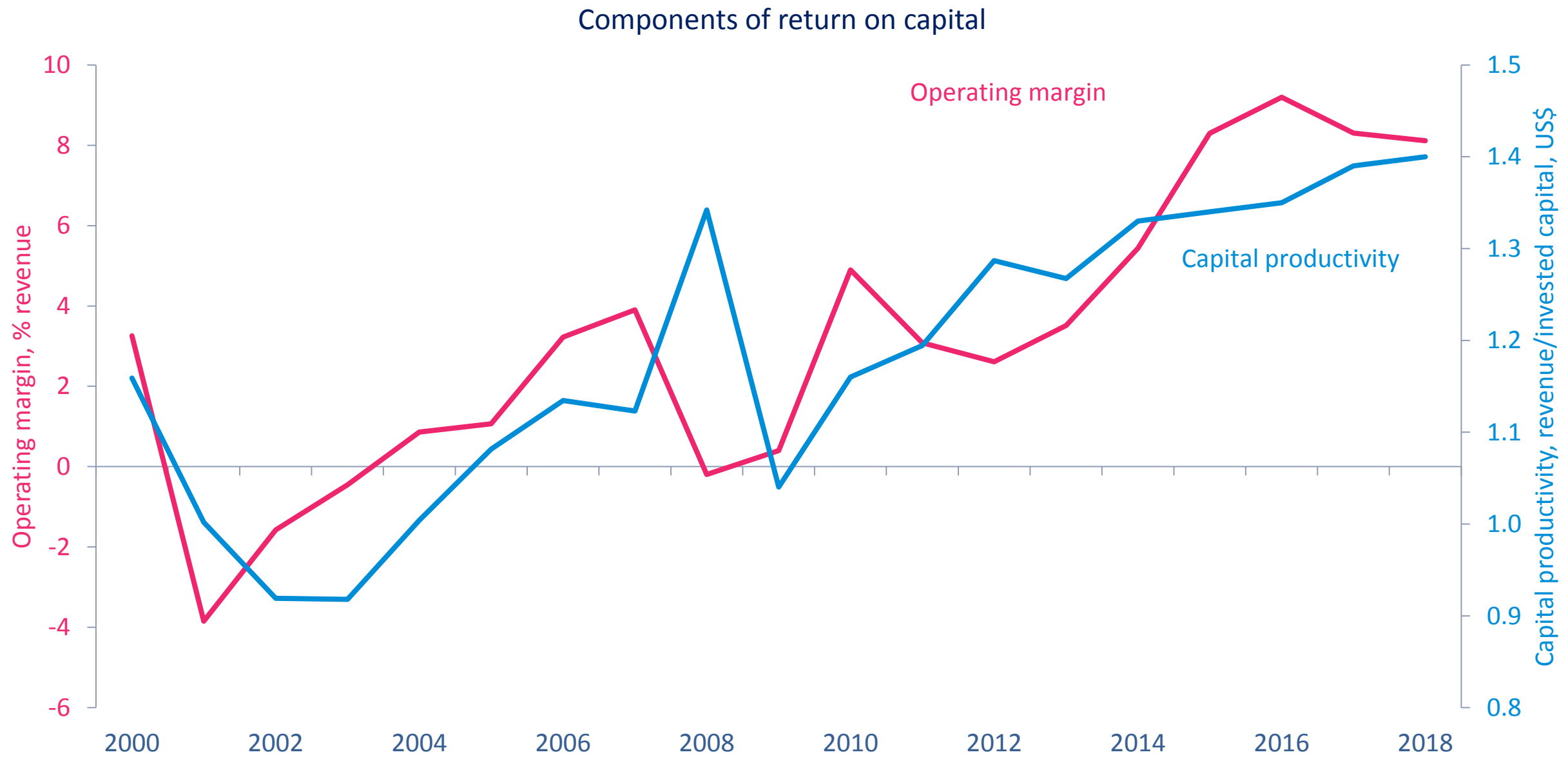
- Prices pushed down towards variable costs,
- But ways need to be found to cover fixed costs:
  - Differential pricing, sequential use of coupons, non-refundable tickets....and now **ancillaries**
- Network density economies through merger prevented by bilateral and O&C regulation barriers:
  - Leading to code shares, alliances and now **ATI JVs** and **equity partnerships** on international markets

# Improvement in performance pre-dates fall in fuel costs



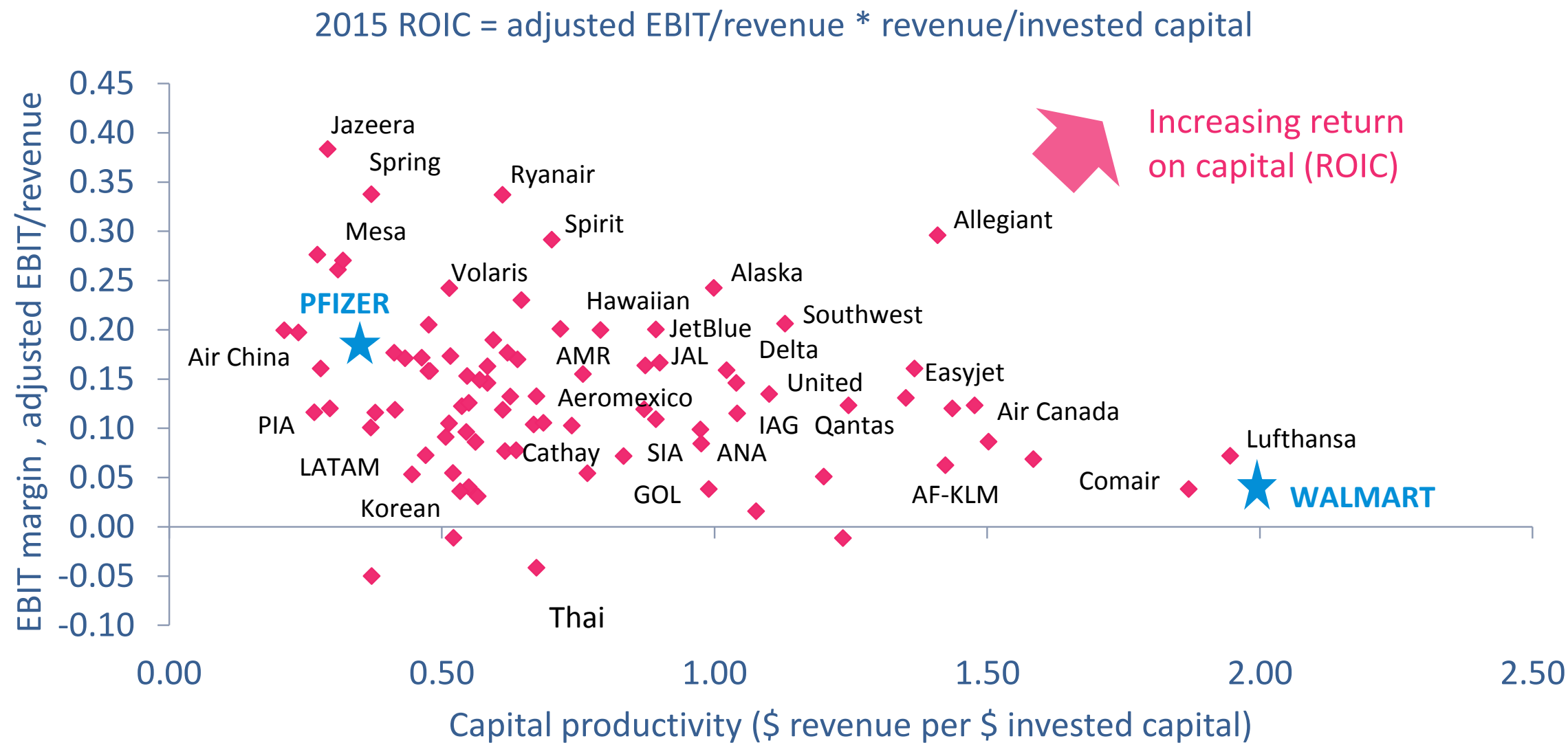
Source: IATA Economics using data from ICAO, IATA Statistics, IATA forecasts

# Airlines are sweating assets as well as improving margins



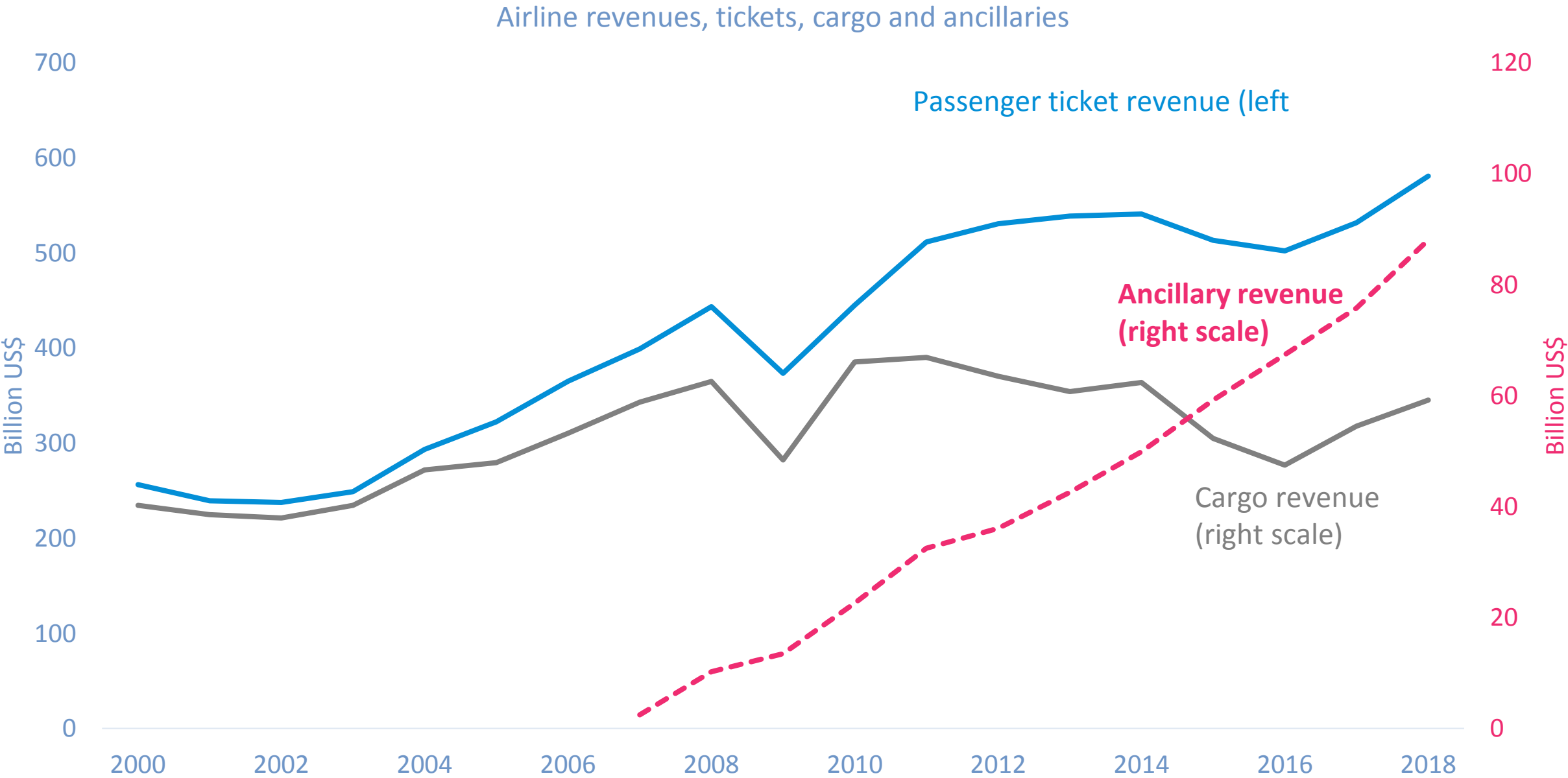
Source: IATA Economics using data from ICAO, McKinsey, The Airline Analyst, IATA forecasts

# Wide variety of successful business models





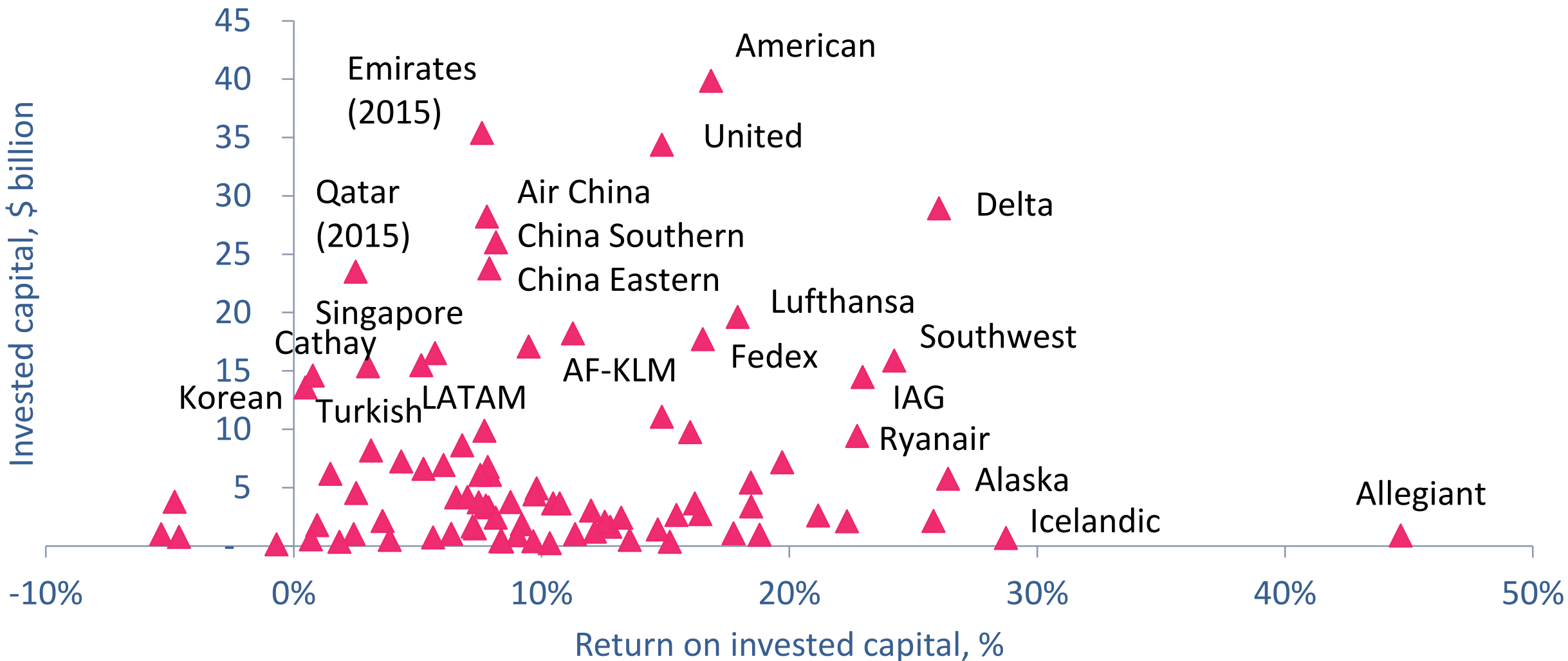
# Ancillaries are changing the nature of the airline product



Source: IATA Economics using data from ICAO, The Airline Analyst, PaxIS, IdeaWorks

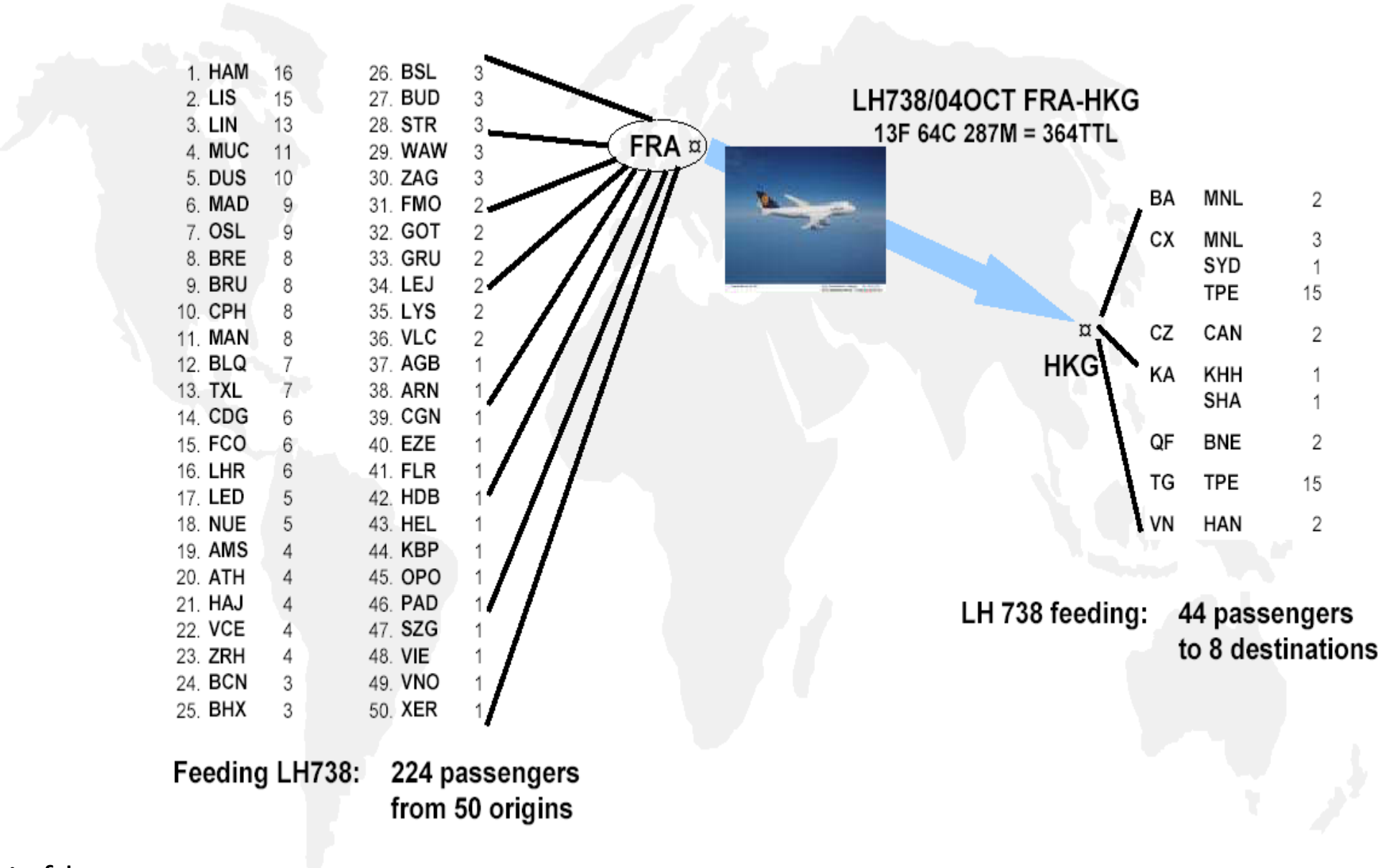
# Consolidation important but not simply because of size

Return on invested capital versus invested capital, 2016



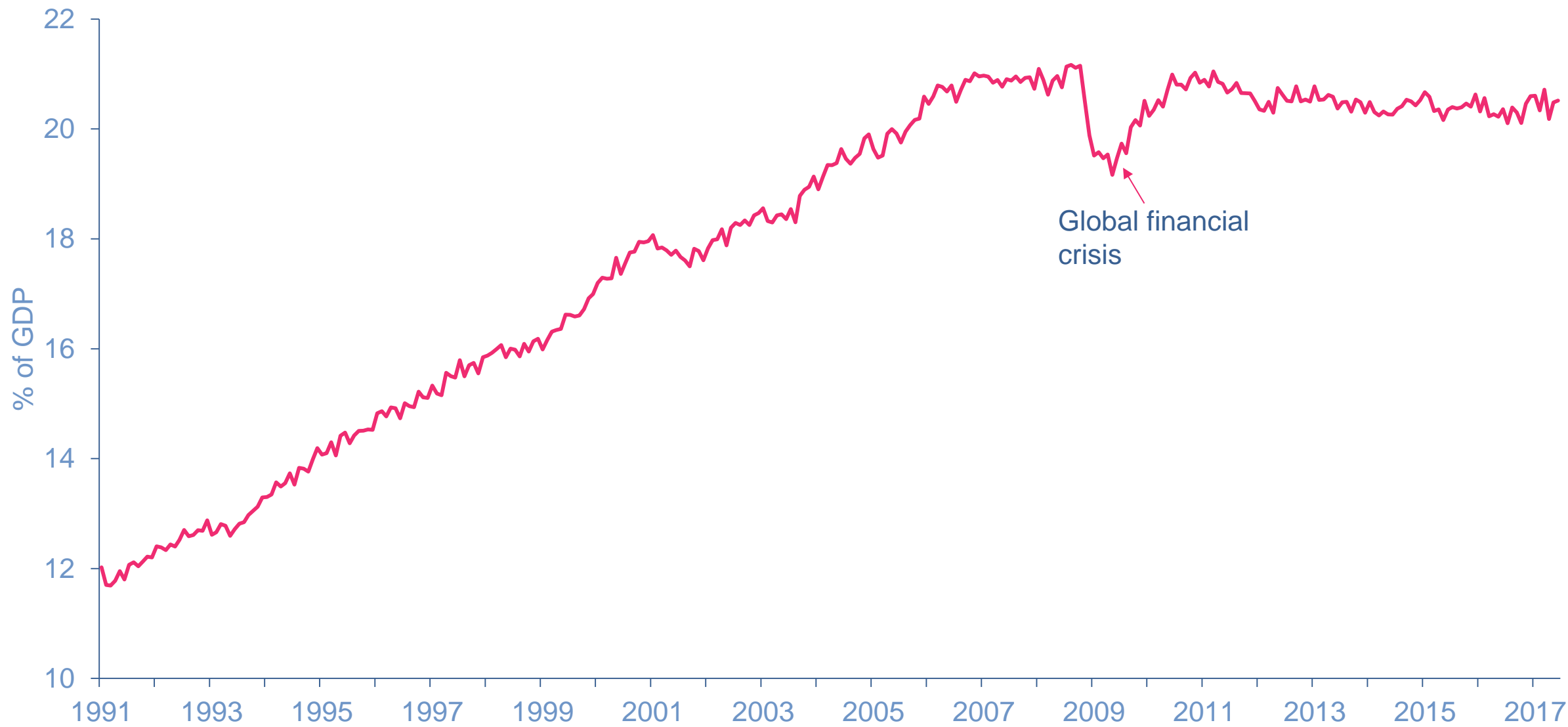
Source: IATA Economics using data from IATA and The Airline Analyst

# JVs doing better job than code shares/alliances to get density economies



# Protectionism (or the new ‘localism’) is a major threat

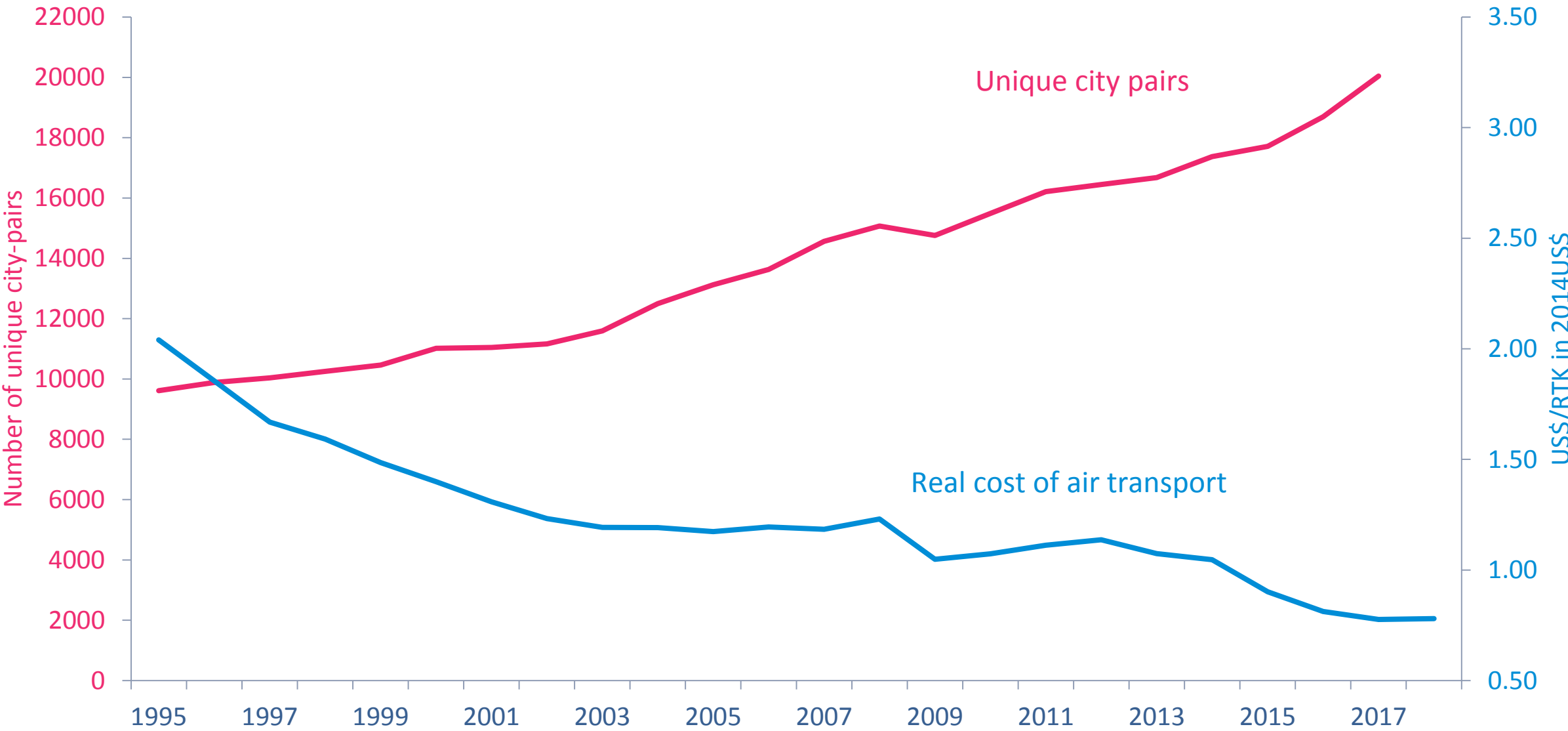
Share of goods trade (exports+imports) in global GDP



Source: IATA Economics using data from Netherlands CPB

# Benefits to consumers (and economy) arise from cheap city connections

Unique city-pairs and real transport costs



Source: IATA Economics using data from ICAO, Boeing, OAG, SRS Analyser

# Wider economic benefits

- Often measured by the jobs and GVA in the supply chain, through I-O models
  - Economic footprint is a useful description
  - But it measures cost not benefit
    - Do labor productivity gains really mean lower wider economic benefits?
- Economic benefits generated by connecting cities at lower cost
  - Air transport network is an infrastructure asset, a bridge between cities
  - Boosting the productive capacity of an economy
  - Generating flows of people, goods, capital, ideas, competitive pressure
  - Raising productivity through agglomeration, gains from trade
  - Higher GDP from the supply-side, in economies close to full capacity
  - Demand-side/spending flows do matter where economies/regions under-developed
  - More research and evidence required!

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