



Survival of the Fittest October 2008

Reaction to the fuel crisis has been many and varied – but mostly it has been vehement. The usual approach for airlines in the most robust condition is to consider more fuel efficient fleets, modify the existing fleet and examine more cost-effective approaches, routes and schedules. Airline treasurers may elect to hedge but that too has its dangers. Any airline that hedged in July before August's sharp descent must have been kicking itself as the third quarter of 2008 came to a close and crude prices started their descent.

Airlines and ground handling agents (GHAs) have had a long period of high fuel prices during which to implement money-saving fuel-purchasing strategies, and room for manoeuvre has become increasingly limited. Many carriers have already streamlined operations and enhanced fuel-saving procedures. For example, American Airlines has a policy of taking on fuel in places where it is least expensive and ferrying it to destinations where fuel costs are high to be used on the aircraft's next flight segment.

For some airlines it is already too late and the repercussions are being felt by handlers as a consequence. Tajuden Abu Bakar, Director of Operations, Malaysia Airlines, points out that oil price rises have already triggered the collapse of several carriers and even well capitalised and well run airlines are bracing themselves for further turbulence. "It is obvious that, when airlines start looking at their operations to trim excesses that bleed them, including loss making routes, and start reducing frequencies to align themselves with passenger demand, the impact will also be felt at ground handling operations," he says. "The equation is simple: fewer flights mean less ground handling, irrespective of the sophistication being introduced in this area of operations."

If the ground handling business can provide safe and high quality products and services at competitive costs to airline operators, this will have a positive impact on the overall commercial aviation industry, he ventures. "Airlines can then pass on the benefits to customers," he says. "So, on one hand, while costs that cannot be controlled become the norm, like jet fuel price hikes, innovative approaches in keeping structural costs well under control will rub off on all related activities of the airline business."

Fuel industry responses

Of course, the industry has thrown up myriad solution providers. For example, Jeppesen, a subsidiary of the Boeing Company, says there is mileage in service consolidation. Jeppesen and World Fuel Services have formed Jeppesen World Fuel Services and Commercial International Trip Planning (CITP). David Vogel, Enterprise Manager of Jeppesen's Airline Operations Centre Services, says: "Since 2002, Jeppesen and World Fuel Services have been providing a fuelling program to customers in the business aviation market. Expanding the service to the commercial aviation market is a natural response to growing demand from airlines. Carriers need to cut fuel expenses and this can be done through attractive pricing and credit terms obtained through combined worldwide purchasing power and supply relationships with major oil companies worldwide."

Gary Murphy, operations manager, CITP, says flight planners from both organisations will work together. "The arrangement provides cost-efficient fuel and international trip planning services."

Raphael Bejar, Chief Executive Officer of Airsavings, points to a few positives and says mid-sized airlines need to expand their horizons on bulk-buyer discounts. They are increasingly banding together to use their fuel purchasing power at airport distribution points. "These costs represent about 15% of the total cost of fuel to the airlines," says Bejar, adding that his company has succeeded in achieving price savings for airlines of about 5-6%.

However, he sees much larger potential savings. The big airlines, including Air France and British Airways, have the advantage of being able to buy direct from the producers and can negotiate a competitive price per barrel. "We are working on negotiating this for the medium-sized airlines," Bejar says.

Bejar reports heightened interest in achieving such savings at a time when hedging is becoming more complicated. "Financial institutions that provide the services are having great difficulty in anticipating forward prices and all carriers are trying to optimise their routing," he points out. There is likely, he feels, to be tighter supervision on the speculators to avoid situations where there is a spread of 30% between the crude and market prices. "It is a difficult area to regulate but the pressure will grow," he says.



But Airsavings, created in 2001 to focus on improving the profitability of small to mid-sized airlines through ancillary revenue streams, cost reduction and group purchasing strategies, sees a few bright spots in the fuel fall-out gloom. Bejar points out that new aircraft construction is entering a renaissance with Boeing and Airbus utilising new materials and global manufacturing processes “to develop the cleanest, most efficient planes we have ever seen”.

Fuel efficiency fixation

Cian Dooley, Chief Commercial Officer of Genesis Lease, who has over 17 years of experience within the aviation and financial services industries, says that, whatever the difficulties, carriers must build fuel efficient fleets if they are to grow their businesses and achieve acceptable and sustained profitability. “When times get tough, airlines more than ever need to rejuvenate their business and restructure,” says Dooley. “When demand falls, it is often cheaper to ground aircraft and furlough pilots rather than fly at a loss which can be the case with older, inefficient aircraft. The aircraft that airlines choose to ground will be those older units that consume higher amounts of fuel. Airlines must try and reduce and renew fleets. That is very hard to do right now but it must be a prime objective.”

Major airlines that have not ordered new aircraft in the past few years will be regretting their decision, Dooley points out. “Manufacturer production lines are taken up with meeting existing orders for a number of years so airlines really have a serious problem. There might be some carriers who will choose to cut their order books. And larger airlines will use their bigger customer status to pressure manufacturers to rejig their order books which will provide the manufacturers with a dilemma. And then airlines will merge or consolidate. If you don't have access to the newer more fuel efficient aircraft and if you have the cash reserves, it can make sense to buy other airlines that do have such access. It can also make sense for carriers with overlapping routes to consolidate. This might allow prices to rise as well as give scope to reduce costs. Unfortunately the human cost is a harsh one. Even the best run carriers with modern efficient fleets could find the next few years a difficult challenge.”

In parts of Asia, Dooley predicts, there will be a continued erosion of the travel agent business to achieve the kind of savings on commission that has very much been the pattern in the West. There will be also be economic pressure in Europe to make air traffic control more efficient. The desire for national control of airspace, and military restrictions, mean there are huge routing inefficiencies and holding patterns around airports can be extremely wasteful. “Individual countries will still want control of their own airspace but the problems will come under increasing scrutiny,” Dooley says.

Andrew Lobbenberg, AMRO research analyst specialising in aviation, says that airlines are shaving costs and endeavouring to raise revenues but the best hope of the majors is that they will benefit from a market shake-out, probably intensifying in 2009. “If a significant number of players go bust, then surviving airlines could find it easier to raise fares. Airlines are trying all possible measures, from single engine taxiing to charging for services such as checked-in baggage and lowering the weight on board of anything and everything from seats to potable water. They are, of course, looking at fuel efficient aircraft but aircraft availability is an issue, as is funding. There is no magic bullet. It is a question of whether airlines are in big trouble or really big trouble.”

Michael Richter, Managing Director and Co Head of US Aerospace and Defence banking at Lazard, says the Middle East, India, China and Russia are propping up demand for aircraft in an increasingly difficult global climate. The International Air Transport Association is forecasting that the airline industry will lose \$40 billion in 2009 as a result of rising oil prices. “And this comes at a time when there is too much capacity in the market and too much cost,” says Richter. And there is a fear that restricted credit markets could force some airlines to cancel orders. “Environmentally friendly aviation is a crucial issue and one that it not going to go away anytime soon,” he points out. “Airlines will have to face these constraints head on and build additional costs to cater for this into their refined business models.”

The A380 and 787 are introducing new benchmarks with their lower fuel costs, lower levels of noise and reduced emissions. At the Farnborough Air Show, Bombardier announced its new CSeries for service entry in 2013 and Mitsubishi in Japan is readying its regional jet – both pledging to deliver significantly improved environmental performance.

“Hand in hand with the OEMs, powerplant manufacturers are stepping up their efforts to develop a new generation of engines, working with the industry's two principal airframers to explore viable alternative sources of fuel to power them,” Richter says. But: “There is still a lot of work to be done and many trials to be carried out – these new bio fuels will have to meet international certification standards – but if approved, this may considerably reduce the US's dependence on imported oil.”



Passing on the pain

For the here and now, increased costs have to be passed on and many airlines are doing just that as they adjust their fuel surcharges. But airlines are not alone in this.

Swissport International, which started applying a separate fuel surcharge of up to 2% under its current contractual agreements as from the middle of June, summed up the realities. "Despite all the internal cost efforts and significant endeavours on all levels Swissport is obliged to make this increase in response to the continued steep rises in fuel prices."

Swissport said it was following an unfortunate but general, industry trend. "Most airlines are suffering from higher fuel prices and have passed on some of these costs to their passengers in the form of fuel surcharges added to their fares. Swissport operates thousands of vehicles and energy generating facilities all over the world and these, too, have seen their fuel costs rise by up to 50% over the past few months."

Spokesperson Stephan Beerli says the increase in the oil and energy cost by the fuelling companies has been exacerbated by the dilution of the US dollar's purchasing power, which is poor compared with the initially budgeted energy cost/barrel rates. He says: "We can save cost by using the right (new) equipment, planning the processes even more economically and by constant and tight control of the cost. But there is not much more handlers can do to save costs. In most cases, the ground handler buys the fuel from the airport or from fuelling companies in volumes that are too small for hedging." The precise details of the new surcharge for the company's products, services and tariffs that involve fuel/energy dependent activities will be determined and implemented locally by Swissport's various stations around the world.

The focus at Swissport, and many other companies, is now very much on what else can be done to trim costs once every conceivable measure has been taken to meet the harsh realities of expenses on the fuel front. Industry analysts report that manufacturers, airlines, GHAs and MRO providers are seeking to achieve lasting fuel savings through economies that can be enhanced by cooperation.

But there is much that can be achieved on the ramp to manage fuel costs. Some airlines have programmes in place to minimise aircraft engine use while parked at the gate. Increases in the number and efficiency of Ground Power Units (GPUs) which supply electricity and air conditioning to a parked aircraft can be cost effective. A GPU burns just one-eighth of the fuel consumed by a jet engine. Similarly, high speed tugs can be used to move aircraft into the maintenance hangar, thereby saving on fuel to taxi the aircraft.

The assimilation of airports with lower fuel taxes in station networks is also a potential. "Shannon has got a very competitive advantage over other airports in relation to fuel price,' says Joe Buckley, Cargo & Technical Traffic Development Manager. "Sometimes the price can be up to one third cheaper than European counterparts. This is helping the growth of our business and since the start of 2008 we have seen strong traffic figures."

The Airport Transport Association said recently that as much as 40% of an airline's ticket price now goes to pay fuel costs, compared with just 15% a little over eight years ago. Airlines and handlers must, therefore, make savings elsewhere of at least 25% per cent to maintain their returns. It is tough and will remain so for some time to come.

Swissport International's views on high fuel prices and the down cycle

Q Have you considered, or are you considering, implementing a fuel surcharge to existing or new customers to cover the rising cost of powering your facilities, vehicles and services?

A Yes, Swissport has considered it and went out with an information to all its customer airlines. The implementation and application takes place locally, in line with the respective local infrastructure situation and the collaboration models with the customers.

Q Are you redefining your passenger and baggage check-in services away from the traditional check-in desks and towards passenger care services or something similar?

A Looking at cost optimisation is a permanent task. Swissport is always looking into new processes and improved solutions. As an example, Swissport was the first ground handling agent to provide to its smaller and medium sized carrier customers a system application with access to a web check-in platform for a smoother check-in process.



Q Do you expect to see a trend towards even more outsourcing of handling to the benefit of the third party handler?

A Yes, definitely. This situation is not brand new either. For this purpose Swissport was developing an interesting approach under the slogan "myport". This is the way to really bring the cost further down.

Q In terms of freight handling, do you think older freighters will be parked and operators will concentrate their cargo handling services in fewer airports?

A This might be possible but is really difficult to predict.

Q Freight handlers will be aware that downward economic pressures tend to force freight out of the sky and onto the sea and road with air carriage called upon for specialist and high value goods. If you agree this is a likely scenario, how are you preparing for this in terms of infrastructure investments?

A This is very much depending on the product and the location. We should not forget that ground handlers are more exposed to such kind of investment risks since many airlines don't want to commit for a very long period. We all know how volatile the market is and how quickly some business partners are changing their suppliers. Airports are in a more comfortable situation.

Q How are you accommodating the drive towards being green?

A Swissport takes this item very seriously by adopting the latest technologies and/or applying meaningful economical procedures. The question is not the goodwill for such kind of efforts but more the readiness from the market to accept a higher price.

Q Where are the opportunities for you as the economic environment becomes more difficult and the aviation cycle declines?

A The ground handling industry is on the move, as it has been during the last three years. We basically believe that the following five points play an important role: consolidation (who is teaming up with whom and where and under which conditions); liberalisation (when are the emerging markets, together with Asia and Africa, opening up towards more deregulation; flexibility (how can you maximise the productivity by keeping a good safety track record at reasonable rates); technology (how can you make use of new systems/tools to keep a grip on the costs with innovative solutions); and frame agreements (which airlines are ready to reduce their supplier lists to work more efficiently with preferred partners and long term commitments instead of opportunistic quick wins).

Goldair Handling's views on high fuel prices and the down cycle

Q Have you considered, or are you considering, implementing a fuel surcharge to existing or new customers to cover the rising cost of powering your facilities, vehicles and services?

A Fuel cost is a major concern for our company for the last few months. We observe the effect of high fuel cost on our own cost structure and we are considering the implementation of fuel surcharge to cover some of the additional cost.

Q Are you redefining your passenger and baggage check-in services away from the traditional check-in desks and towards passenger care services or something similar?

A Until now we have not receive specific instruction or recommendation from our customers-airlines for changes in service provision. In that sense we monitor closely industry trends and we will adjust to the future needs.

Q Do you expect to see a trend towards even more outsourcing of handling to the benefit of the third party handler?

A In the five stations where Goldair Handling provides handling services there are very few airlines that perform self-handling. However we expect to see change towards outsourcing of station management and airport sales desk functions.

Q As the market shifts, some airlines may return to self-handling. Have you considered looking into ways in which, in the future, you might partner with self-handling airlines or even other handlers/airports?

A The third party handling market in Greece is very competitive and Goldair Handling already offers value for money services; however we would think positively about such partnerships.

Q In terms of freight handling, do you think older freighters will be parked and operators will concentrate their cargo handling services in fewer airports?

A Every year we observe an increase of cargo volume that is handled by our cargo warehouses. Also cargo aircraft movements are not affected. At the moment we do not predict a cargo slow down in our region. However we always try to enhance our services trying also to support our customers operations.



Q Freight handlers will be aware that downward economic pressures tend to force freight out of the sky and onto the sea and road with air carriage called upon for specialist and high value goods. If you agree this is a likely scenario, how are you preparing for this in terms of infrastructure investments?

A We have sufficient infrastructure to handle all kind of cargo (VAL, PER, hanging garments, etc) and our current capacity may accommodate well any foreseeable change in the future.

Q How are you accommodating the drive towards being green?

A Through our environmental policy, part of our ISO certification, we make every possible effort for Green operations. We try to have electric and hybrid GSE equipment, natural lighting and ventilation, as well sufficient environmental awareness training in order to use our equipment in an environmentally and fuel consumption efficient way.

Q Where are the opportunities for you as the economic environment becomes more difficult and the aviation cycle declines?

A Our aim is to remain the leading handling provider in Greece and make careful expansion in our region. We already expanded our activities in Cyprus, with the opening of LGS Handling offering Ramp and Passenger services in Larnaca and Paphos. Sustainable growth is the key issue for the future.

