



## EconoMag

The Show that demystifies Economics

Airline Industry - Part 3

**The Global Airline Industry: Airlines' evolving cost equation ©**

by Pierre Vercueil

Welcome back to another edition of Economag on EnglishWaves. Our current theme is the airline industry. In our first episode we looked at a brief history of the industry, including the evolution of long-haul flights and the birth of the jet age. Next, we considered the different divisions of the industry, and the importance of business travellers as a revenue source. Industry costs are however a larger issue. For example, between 2008 and 2010, more than 11 airlines filed for bankruptcy in the United States alone. Airport capacity, network size and structure, and technology are certainly significant factors in the industry. However, key areas for airlines to monitor are labor, fuel and borrowing costs given the industry's sensitivity to these.

Fuel constitutes a primary expense in operating aircraft, thereby making up a large portion of an airline's total cost. Fuel efficiency has become a key consideration in aircraft design given the growth in demand for short-haul flights (takeoffs and landings consume high amounts of jet fuel), together with historically long periods of very high oil prices during the past decade. Boeing's *Dreamliner* was designed as a response to an era of prohibitively expensive fuel. The ultra low cost of oil at the moment, spurred by the price war between OPEC nations, has however helped alleviate the pressure from airlines' delicately balanced cost equation, and encouraged sales of larger, more fuel-hungry aircraft such as the Airbus A380.

Oil price volatility aside, the number one cost consideration of any airline is its labor force. Airlines must pay pilots, flight attendants, baggage handlers, dispatchers, customer service officers, and sales staff. Emirates, for example, has a fleet of 219 aircraft, and employs more than 62,000 people. Singapore Airlines, another industry leader, boasts 108 aircraft and has close to 24,000 employees.

Lastly, changes in borrowing or financing costs can render any business unprofitable, and airlines are no exception. Apart from the world's largest and richest airlines, most carriers buy new aircraft for their fleet by borrowing money. If interest rates increase unexpectedly, some airlines might not be able to service their debt. Similarly, the stability of the currency in which an airline's debt is denominated can be of great risk. For example, South African Airlines renewed its fleet by borrowing in US dollars. But the company's revenues are in South African rands, so as the rand depreciated against the dollar, the airline found itself increasingly unable to payoff its new fleet. The South African government ultimately needed to step in and bail out the airline.

Apart from these aspects, weather patterns are variable and unpredictable and can also constitute additional costs. Extreme heat, cold, fog and snow can shut down airports and cancel or delay

flights. Not always being an insurable risk, this can cost airlines millions of dollars.

In our next episode we'll look at the part of the aviation industry that stays firmly on the ground: airports. As air travel gains popularity and the number of daily flights increases, so too does the size and scope of the world's air travel hubs. More next time. Stay tuned to Economag on EnglishWaves.