

Aviation Strategy

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Alliance angst

The airline industry used to suffer from merger mania; now it's alliance angst - the fear of being left out of an alliance or being outmanoeuvred by a rival alliance. Hence earlier this year UA/DL and AA/US swiftly followed the NW/CO link-up. And in September oneworld was announced, just two weeks after SIA/Ansett/Air New Zealand revealed the consolidation of their alliance.

BA, American, Cathay and Canadian haven't as yet revealed much hard information about oneworld; the joint statement referred to rather innocuous aims like effecting smoother transfers, offering a range of round-the-world products, and enhancing existing co-operation between FFPs. Unlike the SIA alliance, no commitment was made to codesharing, and certainly not to equity stakes. David Turnbull, Cathay's CEO, commented that codesharing was something for the next "two, three or four years", which suggests that Cathay is still cautious about full commitment to a mega-alliance (though obviously not quite as sceptical as we described in last month's *Aviation Strategy* briefing on the airline).

The state of airline stocks probably also influenced the timing of the announcement (see page 4). Unfortunately, there was no significant positive impact on the participants' share prices. Investors are clearly waiting for more tangible evidence of oneworld's benefits.

This raises the key issue of how to measure the benefits (or disbenefits) of alliances. Various airlines' claims are shown in this table, but the benefits refer to revenue enhancement, leaving unanswered the question of bottom line benefits. One might assume that most of the additional revenues generated should fall through to the bottom line, given that the marginal cost of carrying extra passengers is normally very low. However, with load factors at record levels, accommodating extra passengers (perhaps at a lower average yield) may be at the cost of displacing existing clients or putting additional capacity on a route.

Airlines also have to play a political game in estimating alliance benefits. If regulators could be persuaded that the benefits were coming from cost savings there would be no problem, but none of the groupings are presently tightly knit enough to realise significant operating economies; regulators are more likely to believe that the benefits are being extracted from passengers. After all, the underlying rationale for alliances is to dominate traffic flows between the members' hubs and hence improve yield on these routes, a strategy which is only constrained if there is effective network competition from other alliances.

Given that alliances do not stimulate overall traffic growth, there must be losers as well as winners (though all three US groupings claim that the benefits from their prospective alliances will be \$200m-\$300m p.a.). And the losers are not necessarily those outside the mega-alliances - independent, point-to-point operations can be the most profitable of all - but may include those within groupings. As the market deteriorates, the smaller alliance members must be careful that they aren't exploited by the major partners, and turned into regional feeders.

ALLIANCE BENEFITS

Airline	Region	Revenue	Alliance enhancement	Enhancement as % of revenue
Delta	Atlantic	\$2,223m	\$138m	6.2%
KLM	Atlantic	DF12,011m	DF1400m	19.9%
Lufthansa	Atlantic	DM3,000m	DM300m	10.0%
Northwest	Atlantic	\$644m	\$65m	10.1%
Qantas	Kangaroo	AS\$723m	AS\$35m	4.8%
United	Atlantic	\$1,745m	\$120m	6.9%

Note: For latest financial year - 1997 or 1997/98.

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oneworld, oneunion?

The launch of oneworld has significant implications for organised labour. Here, *Aviation Strategy* looks at how unions representing employees at British Airways, American, Cathay, Qantas and Canadian are reacting to the alliance through the creation of the "Oneworld Solidarity Alliance", and examines the prospects for union solidarity across airlines.

A trade union alliance - the ABC Alliance - had already been set up in July of this year in anticipation of the oneworld alliance, representing cabin crew and ground staff working for British Airways, American Airlines and the other airlines expected to become members of oneworld. This union alliance, now renamed the "Oneworld Solidarity Alliance", will join similar union pacts set up to co-ordinate organised labour's responses to airlines' alliances.

The table on the right shows the extent to which pilots' unions and those of cabin crew and ground staff have already responded to the alliances by creating their own groupings. The potential for international solidarity is greater among cabin crew and ground staff, since the majority of these workers are affiliates of the International Transport Workers Federation (ITF), the powerful, London-based international union federation. Some pilots' unions, such as the American Airline Pilots Association (AAPA), are affiliated to the ITF, while others, such as the non-affiliated British Airline Pilots Association, only have informal links at present.

The tentative trend towards global unions groupings might prompt airline managements to wonder if - in creating their own alliances - they have propelled trade unions towards greater international co-operation and solidarity? This could rebound on airlines in the form of stiffened resistance to changes in working practices, outsourcing and other attempts to control labour costs. Pilots' strikes at Northwest and Air Canada,

for example, indicate a degree of militancy already exists, although these actions are not directly linked to alliances. On the contrary, other pilots unions within alliances helped undermine these strikes as Northwest shifted as many Atlantic passengers as possible over to KLM and Air Canada re-routed its traffic to United services at Chicago.

International solidarity?

The ITF's ambition to emulate in aviation its success in the shipping industry, where it sets international labour rates and collects union dues, may therefore yet be frustrated.

Keeping a united front against alliance airlines which may seek to transfer jobs to lower-paid nationals will be the real test of the unions' solidarity. Airlines will no doubt hope that pragmatism - more jobs for members, keeping existing jobs or retaining existing conditions for individual unions - will prevail over idealism, and so undermine any international solidarity. But unions argue that alliances have to take their workforces with them if they want to create a seamless, globally-branded entity, and so divide-and-rule tactics would be counter-productive.

Unions accept that there has been as yet no significant attack on jobs or conditions from the alliance airlines, but insist that the

ALLIANCES AND UNION GROUPS

Alliance	Union group
Star	Association of Star Alliance Pilots Star Solidarity Alliance
Swissair/Delta	Global Pilots Alliance Alpha Alliance
AA/BA+others*	AA/BA group pilots ABC Alliance**
KLM/NW/Alitalia	KLM/NW pilots/ ground staff/cabin crew

Note: *Now oneworld ** To be renamed "Oneworld Solidarity Alliance".

Source: International Transport Workers Federation.

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threat hangs over their members. The ITF, for example, says that Qantas benchmarked ground staff costs after its tie-up with British Airways and threatened to use outside contractors. Union unease has already resulted in some concessions. The ITF also points out that British Airways has transferred some of its ticketing and administration to Bombay, a route that Qantas is expected to follow.

Any talk, however, of alliance-based "supranational" collective bargaining is quickly dismissed by the unions themselves (although a trend towards centralisation of union activities is seen as inevitable). With whom, for example, would a centralised alliance-based union grouping negotiate if not the individual airlines? Only the Star alliance appears so far to have any centralised employment policy with its vacuous-sounding "People's Policy".

In addition, alliances can add and drop member airlines and are linked to non-alliance airlines through bilaterals, making the task of the unions more difficult.

The best unions can hope to achieve is an exchange of information between them-

selves, just as airlines now more readily swap "benchmarking" data, so that they are better armed when going into negotiations. In different countries the degree of access to information can vary greatly, with Scandinavians and Germans, for example, benefiting from national legislation which puts employee representatives, including union officials, on companies' supervisory boards. This could enable them to challenge the benchmarking figures where they suspect airlines have manipulated them to their own advantage.

The realistic prospect for the trade unions is that they maintain an acceptable degree of solidarity and achieve a consensus on a draft set of basic demands such as the rights to belong to a trade union, collective organisation etc. These are the kind of demands airlines should be able to accept without committing themselves to anything that either increases labour costs or leaves themselves open to industrial action. If oneworld works, there will still be many unions - albeit more co-ordinated and better informed - to deal with.

An irrational fear of job losses?

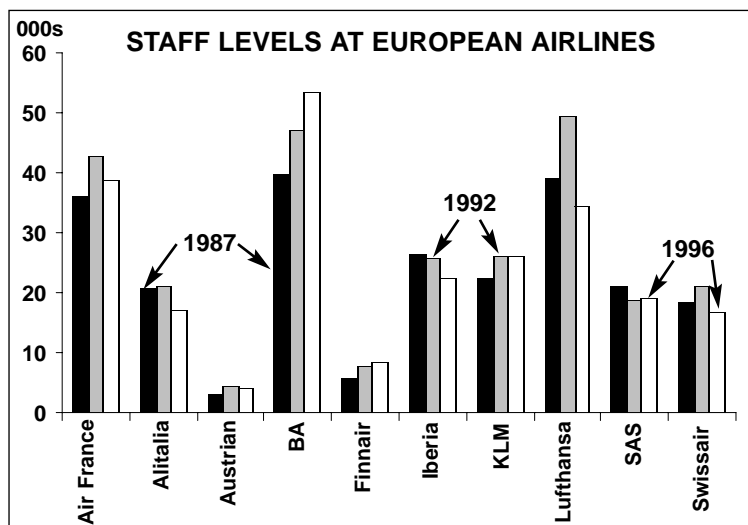
In Europe, union officials fear that airline alliances will accelerate the steady erosion in jobs over in the 1990s.

Whether global alliances will lead to serious job losses long-term remains to be seen, but in fact European job losses have not been as bad as some have imagined them to be - if you look back over a 10-year period (see chart, left, which is based on IATA figures), rather than just the last few years.

While total jobs at these 10 airlines fell by 9% over 1992-1996, if 1996 is compared with 1987, total jobs have actually *increased* by 3% (to a combined workforce of 239,000) over this period. And this includes the apparent decrease in personnel at Lufthansa, which is actually due to the airline not including maintenance staff in its IATA returns any more.

The unions point out that this analysis is misleading, since what matters to their members is the current trend for job losses. Certainly, in the 1990s virtually all of Europe's airlines have adopted cost-

cutting and productivity improvement programmes, most of which include job losses. But the fact remains that there were still more people employed in Europe's major airlines in 1996 than in 1987.



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Airlines lose up to half their value in two months

For much of the first half of the year, the stockmarkets on both sides of the North Atlantic were charging round in a seemingly endless bull market (see chart, below). Like all good bulls, this one seems to have been chased out of the shop by a big bear, the last bit of china to break being - as it were - the Russian samovar. In this process airline stock prices have been taken on a roller-coaster ride.

With one or two exceptions, the share prices of the major airlines in Europe and the US peaked in July, registering all-time highs in many cases. Two months later they stand some 45% below their peaks (see table below - which may well be out of date by the time *Aviation Strategy* reaches subscribers because lows may be even lower now).

Of course, this movement should be seen in context of the markets. However, in terms relative to the performance of the local stock market indices, they have also fallen dramatically from the relative peaks. There are of course some exceptions - the prime one being Southwest Airlines, whose shares recently hit another high.

The mini-crash and industry fundamentals

Airline shares are somewhat volatile investments, but what do these recent moves tell us about the industry's fundamentals? Some of these moves are specific to individual carriers - the strike at Northwest has been disastrous for the mid-west carrier, so the 60% underperformance of their shares in relative and absolute terms may be understandable. Equally the recent tragic crash of one of Swissair's MD-11s has undermined sentiment towards the holding company's shares.

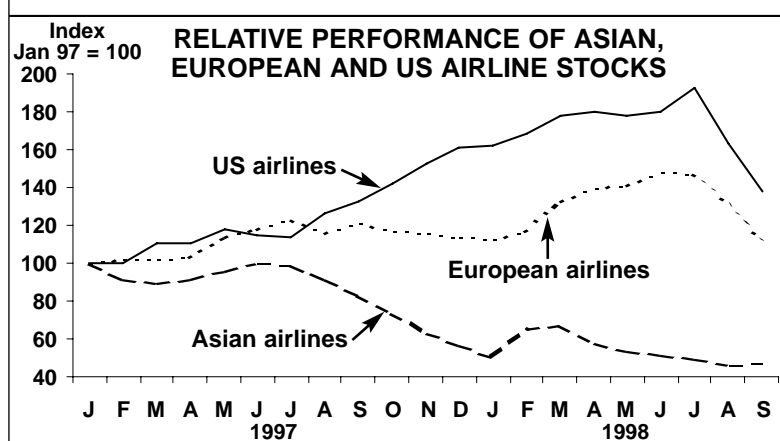
However, the airline industry may be seen as one that surfs on the crest of the economic wave, so that with a fear of economic slowdown or recession - either globally or locally - their shares are among the first to be affected.

On industry specifics there are many signs that bear comparison with previous peaks in the airline industry cycle - not least of which is the state of the aircraft order backlog. Capacity is also rising faster than traffic (although by only 2% on international routes to/from the US and by less than 1% on European international flights).

Add to this the continuing bad news coming from Asia (see pages 8-9), Russia and Latin America, and it may be hardly surprising that investors fly to safety. It may not be that the stockmarket forecasts a full-blown recession - and it would be a first for the recession not to occur in conjunction with high oil prices - but it may well be that it fears it.

EUROPEAN AND US AIRLINE STOCKS					
	High	Price	Low	Price	Low/High
Alitalia (Lira)	10-Apr-98	8,738	28-Oct-97	2,373	-45%*
BA (£)	7-Jul-98	703	28-Sep-98	374	-47%
Lufthansa (DM)	8-Jul-98	55.3	28-Oct-97	29.3	-35%
Swissair (SFr)	15-Jul-98	517	25-Sep-98	287	-44%
KLM (DFI)	15-Jul-98	97.7	28-Sep-98	53.2	-46%
SAS (NKr)	3-Jul-98	137	21-Sep-98	75	-45%
American (\$)	14-Jul-98	89.25	4-Sep-98	50	-44%
Delta (\$)	14-Jul-98	142.19	4-Sep-98	93.63	-34%
Northwest (\$)	16-Mar-98	64.19	10-Sep-98	25.75	-60%
US Airways (\$)	6-Jul-98	81.63	26-Sep-97	40.88	-29%
United (\$)	21-Oct-97	100.75	4-Sep-98	56.5	-44%

Note: Alitalia low/high refers to shares on an undiluted basis.



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How will the Canadian market evolve?

In 1997 there was a unique aviation achievement in Canada: both of the major carriers - Air Canada and Canadian Airlines - reported a net profit. Since then, however, the situation has deteriorated again and now a new entrant - WestJet - poses a new threat to the incumbents.

Air Canada: a European American

Although it had already been privatised for some 10 years when the Canadian industry was deregulated, Air Canada still occasionally gives the impression of a state-supported European flag-carrier rather than an all-commercial North American airline. This was evident during the 14-day pilot strike in September, which completely grounded the carrier.

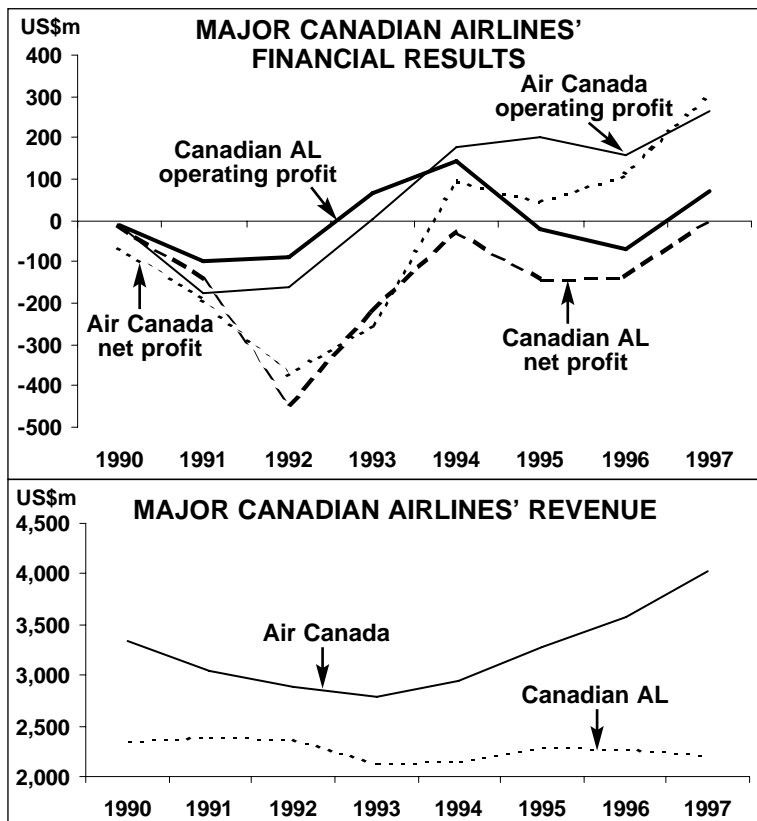
The pilots ended their action accepting a 9% pay rise over the next two years plus improved conditions - an offer which was on the table before the strike - although the pilots had originally demanded a 20% increase. Much of the argument between the union and the management concerned cross-border pay comparisons, with the pilots claiming that their salaries had drifted well below those at the leading US Majors. Management's response was that this apparent trend was largely the result of exchange rate changes: the Canadian dollar has fallen to an historical low (64 US cents) against the US currency.

The impact of the strike on Air Canada's finances is going to be significant. Bottom line losses caused by the strike are estimated at C\$290m (US\$201m), according to the airline. Although Air Canada reported a net profit of C\$427m (US\$308m) in 1997, C\$201m of this came from the sale of its investment in Continental, so it is no longer certain that Air Canada will be able to produce a profit for the whole year. Moreover, it

is almost inevitable that Air Canada will have to concede the same pay rises to the other employees, so increasing its annual costs by about C\$60m (US\$42m).

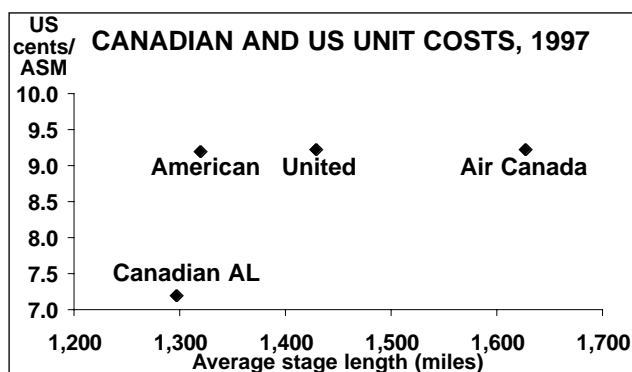
There is also the question of winning back its customers. Air Canada's service reputation was badly damaged by the strike, especially by actions such as turning back aircraft on Canada-Caribbean routes in mid-flight on the day the strike was called. The airline's immediate response was to offer treble miles on its Aeroplan FFP, a move designed to appease its core customers - the fewer than 100,000 passengers who, according to Air Canada's own calculations, contribute more than 80% of the airline's profit.

Air Canada's concentration on the business traveller sector does push up its costs. But it is still clear that its unit costs, taking



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into consideration the weakness of the currency and its long average stage length, are out of line with its main competitor Canadian and the two mega alliance partners south of the border.

Lamar Durrett, Air Canada's CEO, has announced various measures to tackle the cost problem, including rationalising the network in the west of the country, shifting more operations to its regional subsidiaries like Air BC, redeploying aircraft on transborder routes and cutting maintenance costs by establishing joint operations with its Star partners.

These initiatives now look inadequate following the strike and the imminent escalation in labour costs. In addition, the fragile, tax-burdened Canadian economy is already feeling the fall-out from the Asian crisis, and the prospect of a recession is now widely feared.

Nevertheless, Air Canada has been remarkably successful in the US-Canada open skies environment, developing a hub avoidance network from Toronto to US cities that regularly uses 50-seat Canadair RJs. It has been protected from full-scale US competition as the agreement initially limited US carriers' entry into Toronto Pearson.

That protection is now over but Air Canada has succeeded in developing a fortress hub at Toronto - commanding about 70% of the market - as part of its Star alliance strategy. By combining with United it achieves very high market shares on routes to its US partner's hubs at Washington and Los Angeles, although American's strong presence at Chicago provided effective competition to AC/UA services. Not surprisingly Air Canada has fared much less well on

routes to hostile hubs like Dallas and Atlanta, and has been forced to downscale operations there. US expansion into the Toronto market should be limited to routes that take advantage of their respective hub strengths.

One of the reasons that Air Canada has been able to return profits in recent years was a change in attitude to Canadian Airlines. Air Canada used to compete too strongly against its Calgary-based rival, with the management evidently believing that there was not room for two full-service international airlines in the Canadian market. Air Canada's actions helped produce a miserable series of results for Canadian (it reported a net loss for every year during 1990-96 and a minuscule profit in 1997), but they also contributed to its own negative results in the mid-1990s.

Canadian's problems

Canadian, one-third owned by American, has teetered on the edge of bankruptcy several times, notably in late 1996 when it suspended creditor payments for 3-6 months and had to be supported by a fuel tax rebate from the provincial governments of Alberta and British Columbia. 1998 first-half results were again very disappointing (see table, right), raising more doubts about the carrier's survivability, although it did react effectively to the Air Canada strike, adding 20 flights a day to its domestic network.

Canadian faces three very serious problems. First, its codeshare agreement with American enjoys antitrust immunity, but intra-alliance relations are not all that harmonious. Under pressure from its own pilots' union, American recently forced Canadian to hand over some key transborder operation, so damaging Canadian's revenue. (Incidentally, one of Canadian's strengths at present is perceived to be the position of Douglas Carty as CFO as he is the brother of American's CEO, Donald Carty.)

Second, Canadian's key strategy focused on building up its Vancouver hub, offering about 120 flights a week to eight of the ten top Asian points. The Asian crisis has evidently put a serious dent in this strat-

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egy. Canadian had intended to increase its US-Asia traffic, marketing the CP/AA code under antitrust immunity. Now, however, with Cathay Pacific in the oneworld alliance, Canadian risks being marginalised. The Vancouver hub has also come under attack from Alaska Airlines, although the US airline is expected to retrench.

Third, Canadian faces increasing competition in the west of the country from a new entrant that might just evolve into a northern version of Southwest.

The WestJet threat

WestJet, established in 1994, operates nine 737-200s out of Calgary and has plans to increase its fleet by seven during 1999/2000. It has found a profitable niche serving the VFR market in western Canada. Distances between the western triangle (Calgary, Vancouver, Edmonton) are such that air travel has to be the main mode of transport.

WestJet's success is that it has been able to stimulate this market even though it defies conventional wisdom by operating at low frequencies (one to five flights a day). An explicit aim is to persuade customers to increase the number of flights that they take.

WestJet employs all the standard strategies associated with successful low-cost operations. It flies an homogeneous 737 fleet, and has so far avoided the temptation of new equipment - the seven 737s it is buying from a leasing company will cost US\$30m in total. Sales are mostly direct, with an emphasis on selling through the internet. It tries to project a relaxed image, with humorous messages and adverts.

By its own calculations WestJet's unit costs are 43% below those of Air Canada or Canadian on a stage length adjusted basis, but it still faces vigorous competitive responses from the incumbents when it enters new markets. They normally match WestJet's fares within 72 hours - with capacity controls to limit yield erosion - or through offering two or three times normal rewards on their FFPs for travelling on WestJet-operated routes.

These tactics do not seem to be working. As with the Ryanair experience in Europe, the WestJet effect has been to generate new, low-yield markets. And the major carriers, by advertising their own new low fares, have destabilised the economics and value of their premium product.

In 1996, its first full year of operation, WestJet was present on five of Canada's top 25 city-pairs; on these routes the average traffic growth was 36%. On the 12 city-pairs without any low cost competition average growth was 11.4%. (On the remaining eight routes low cost competition was provided by the now defunct Greyhound; average traffic growth was 15%.)

WestJet has definitely damaged Canadian's yields and volume in the west, and Air Canada recently announced that it will remove some capacity from markets that WestJet serves.

Possible IPO?

For a start-up, or indeed any airline, WestJet has a solid balance sheet - C\$43.5m (US\$30m) in equity and C\$11.5m (US\$8m) in debt at the end of June, and the airline has been consistently profitable in its early rapid expansion phase.

Although a private company - it is owned by its founder, chairman and CEO, Clive Beddoe, who is also chairman of a successful real estate development company, and other managers - WestJet filed in August a "non-offering prospectus" with the Toronto stock-exchange, raising expectations of an IPO.

Stockmarket conditions have of course deteriorated since then, but the move is an indication of the carrier's ambitions. In the non-offering prospectus the airline often compares itself to Southwest (but then so does every new entrant seeking to raise capital), and speculation in Canadian avia-

FIRST-HALF 1998 RESULTS					
US\$m	Revenue	Operating profit	Net profit	Operating margin	Net margin
Air Canada	2,049	106	45	5.2%	2.2%
Canadian	1,020	-22	-57	-2.1%	-5.5%
WestJet	34	3	1	8.3%	3.7%

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tion circles is that WestJet is looking to intensify its campaign in Canadian's western territory, then expand into the east - Air Canada's domain.

An objective analysis of the Canadian market (geographically the country is huge but the population is only about 22m, 38% that of the UK) might suggest that there should not be two traditional, full-service airlines. One full service flag carrier plus lower-cost, product-differentiated international and domestic rivals is the norm in deregulated European markets.

However, as Tony Hine of First Marathon in Toronto points out, the eastern city triangle (Toronto, Ottawa, Montreal) is also known as the "Bermuda Triangle" for new entrants: no new entrant has survived in this market.

Expansion in Canada is also complicated by the presence of a large and successful charter sector (as in the UK and Germany, but hardly at all in the US). The main players - Air Transat, Royal Airlines, Canada 3000, and Skyservice - operate in an interesting market. As well as the summer operations to European destinations and transcontinental-

ly within Canada, there are also winter operations from the frozen north to Florida and the Caribbean, creating a second peak that is countercyclical to the European market.

Transat is the biggest tour operator in Canada and through a subsidiary owns the third largest tour operator in France plus 50% of Star, a French charter. First Choice set up Air 3000 and its UK charter subsidiary, Air 2000, provides the Canadian airline with capacity.

But, as in Europe, the charters have no serious plans to expand into the scheduled sector (their equipment is the wrong size). If anything WestJet could expand its own charter activity - last year it won a contract from a tour operator for flights to Reno, Palm Spring and Las Vegas. This is a useful supplemental strategy for maximising aircraft utilisation.

It may seem improbable that a newcomer like WestJet could undermine part of the mighty oneworld alliance and change the structure of the Canadian industry, but it does seem to have found a formula that works in that market.

Philippine Airlines is dead; long live PAL2?

As the corpse of Philippine Airlines barely has time to grow cold, creditors and rivals are crowding round to salvage or exploit what they can from the situation.

Allotting blame for the demise of PAL will do little to help the situation of the 8,000 employees now out of a job, but a combination of the Asian crisis, stubborn unions and poor management (responsible for over-ambitious expansion plans and aircraft ordering) meant that the airline had little chance of survival.

It has to be remembered that corporate failure is an everyday fact of life in all industries, and aviation is no exception - even flag-carriers. But what happens next at the group of assets formerly known as PAL? Rough calculations show that PAL has assets of around \$2.1bn, virtually the same amount that the car-

rier owes to its creditors. These include European banks, owed more than \$1.2bn for loans to purchase Airbus equipment; the US Export-Import Bank, which loaned PAL \$400m for Boeing aircraft; and local (Philippine) investors and banks, owed around \$500m.

In a liquidation situation however, it is unlikely that every asset will be sold for its true market worth. The banks are not waiting to find out though. The US Export-Import Bank seized a 747-400 in Los Angeles the day before it was due to make its last homeward journey, leaving passengers to transfer onto other airlines. Many creditors are angry that they had not been able to repossess assets before PAL went under, as The Philippines' Securities and Exchange Commission had put the airline into receivership since June, pending a reorganisa-

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tion plan (that was never completed). It is hard though to feel too sorry for the banks involved in this situation - they assessed the risk of lending to PAL, and thought the returns were worthwhile

What will replace PAL?

Much more important, however, is the question of who will replace the capacity provided by PAL - assuming that no last-minute white knight comes to the rescue?

International airlines - such as Singapore - have been criticised locally for immediately putting up fares on routes to/from The Philippines where there is now no competition. Capacity from international airlines is also being increased to The Philippines, but domestically the void left by PAL (which operated 80% of domestic flights) will have to be filled somehow.

Short-term, Cathay is doing that by operating five A330-300s on certain domestic routes, following a request by Joseph Estrada, The Philippines' president, on September 26. Classified as "charters", Cathay's flights are meant to be temporary, but that will depend on whether Cathay is involved in any resurrection of PAL (so-called PAL2) or whether a domestic airline can take over.

At present Cathay has a 30-day wet-lease contract (which started September 28) that it says is being operated on a cost-only basis (i.e. the government is guaranteeing Cathay against any losses). This could be considered as defensive action by Cathay - precluding a competitor from muscling in on virtual home territory - or as a gesture of goodwill prior to Cathay involvement in a PAL2. Whatever the motive, Cathay's share price rose 10% on September 28 when the contract was announced.

In The Philippines many would prefer a Philippine airline to take over at least the domestic routes in any PAL2. Air Philippines is the most obvious candidate, although it only has 14 aircraft - eight 737-200s, two MD-82s and four YS-11s. However, Air Philippines can only operate the MD-82s at present, due to a suspension by the local civil aviation office following alleged safety violations. Another MD-82 is due to be leased any time now (1st October), but the airline needs much more capacity than that.

Talks between Air Philippines and Lucio Tan (majority-owner of PAL) for the lease or purchase of 737s, A320s, and Fokker 50s are ongoing, it is claimed.

But in order to take over PAL's long-haul routes (subject to regulatory approval), widebodies will have to be acquired from somewhere. Leasing companies are believed to be negotiating with Air Philippines, and widebodies are cheap and plentiful at the moment. But whether Air Philippines can afford to buy or lease them is another matter.

Logic versus reality

In pure business terms it would be more sensible to have a (relatively) stable, existing operator such as Cathay take over PAL's routes than a troubled and tiny domestic airline, but very little is ever decided on business logic in The Philippines. If a PAL2 decided not to employ all or any of the former PAL staff and/or a foreign airline had a large stake (and a source at Cathay, for example, says that it would not be part of PAL2 if the unions were involved), then unions could try to stop the rebirth of PAL. The unions may see a comparison with what Lorenzo did at Continental, using Chapter 11 as a method to start the airline again from scratch.

The most politically soothing outcome would be for PAL2 to emerge with a variety of shareholders, with both Air Philippines and Cathay taking a piece of the action. Majority control could still rest with "local investors" - i.e. Lucio Tan, Air Philippines and the government, but in practical terms day-to-day management would be left to Cathay.

And if Cathay management does end up in charge of PAL2, the first problem it will have to solve will be how to reduce losses domestically. Low domestic fares are the norm but offer no realistic path to making a profit. Lower capacity and higher fares would be logical on domestic routes, but it would take very brave management - Cathay or otherwise - to take such a step.

Whoever is part of PAL2, the entity will have to be shielded legally and financially from the debts of the original PAL. Any asset that Philippine Airlines transfers to PAL2 will have to be at full market value, otherwise PAL's creditors may be even more upset than the unions are.

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Operational problems bug America West recovery

After 18 months of strong profit recovery, America West is again struggling with operational reliability problems that look likely to result in flat earnings for the third quarter of 1998. A hefty fine for maintenance violations, FAA-imposed revisions to work practices, lagging staff morale and tough labour negotiations are the latest challenges facing the second smallest US Major, which has otherwise kept its unit costs low and positioned itself well to capture higher-yield traffic. How quickly can America West pull out of its present crisis?

Unlike its partner Continental and other airlines, America West met with immediate financial success after its Chapter 11 reorganisation. It emerged from a three-year spell in Chapter 11 in August 1994 with six consecutive profitable quarters under its belt, a slightly reduced scale of operation, low unit costs and one of the strongest balance sheets in the industry. It was one of only two US Majors to report a profit for 1993. Its operating profits of \$146m and \$156m in 1994 and 1995 respectively gave it the highest profit margins (about 10%) among the full-service Majors.

But earnings dipped sharply in 1996, in part because of a \$65m special charge (related to an earlier A320 order) but also due to a decline in yield and operational problems experienced in the third quarter. The latter meant record cancellations and poor on-time performance, as a result of which the airline ranked near the bottom of consumer surveys in 1996. The situation was not helped by the resumption of rapid growth and a late-1995 decision to outsource heavy maintenance, which angered the unions.

In late 1996 and 1997 various programmes were initiated to improve operational performance, customer service and staff morale. These included task forces to tackle specific areas, focus groups with high-profile customers, employee incentive programmes, hiring extra staff in maintenance and key customer service areas, developing a more efficient reservations system, and improving in-flight food service.

These efforts paid off. America West climbed to top position in "least mishandled baggage" in the DoT's domestic service quality rankings for 1997 and significantly improved its on-time performance.

America West has succeeded in consistently maintaining its unit costs at around the 7 to 7.5 cent mark. But its yields and unit revenues have lagged well behind those of competitors. The resumption of profit growth in 1997 and the excellent profit margins achieved in the first six months of 1998 were possible only because of significant improvements on the revenue side.

The company posted record operating and net earnings for 1997: \$162m and \$75m respectively. The second quarter net profit of \$41.4m was the best quarterly result in its 15-year history. In the first six months of this year, operating income rose by 50% to \$126.1m and net profit by 80% to \$66.6m.

Much of this was attributed to a "re-engineered revenue management strategy", which meant cutting back on fare sales and shifting focus to business travellers by improving schedules, boosting frequencies and adding flights to key business centres. However, America West has also benefited from the general stabilisation of the West coast competitive environment.

These factors led to a 11.5% surge in yield in the March 1998 quarter, while traffic and load factor fell by 8.7% and 6.6 points respectively. The yield rose by another 5.3% in the June quarter (or 7% if adjusted for an increase in the average stage length).

So it very much looked liked America West had come of age. The first-half results represented 12.4% and 6.5% operating and net profit mar-

AMERICA WEST FLEET PLANS

	Current fleet	Orders (options)	Delivery/retirement schedule/notes
757-200	13	0	
737-100	1	0	
737-200	17	0	
737-300	46	0	
A319	0	22	3 in 1998, rest in 1999-2000
A320	29	21*(40)	2 in 1998, rest in 1999-2000. Options are for A320 family
TOTAL	106	43 (40)	

Note: *12 A320 orders are subject to reconfirmation.

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gins respectively - no longer out of line with those reported by the larger Majors. The first quarter yield of 12.2 cents per RPM was similar to competitors'. With further revenue benefits in sight (at least \$20m annually from new technology), the company appears to have positioned itself well for further yield and profit improvement.

Like its larger competitors, America West has used profits to strengthen its balance sheet and enhance shareholder value. Long-term debt fell from \$468m at the end of 1994 to \$227m at the end of June 1998. The company had an adequate \$230m in cash on June 30. It has repurchased some \$125m of its equity since early 1996, and a new buy-back programme was authorised in August 1998.

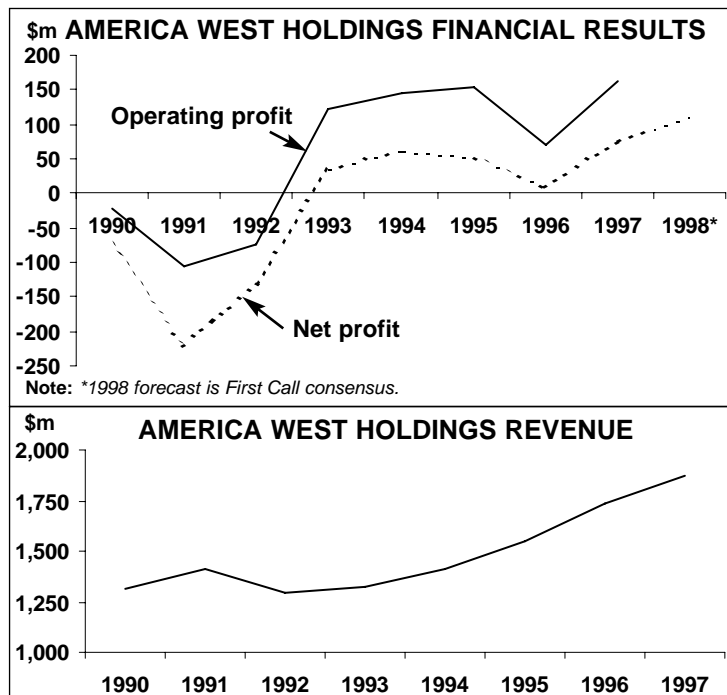
But the celebrations about the yield recovery and the prestigious customer service award turned out to be short-lived, as America West again began experiencing operational problems in the summer. In July America West came last in the DoT's on-time performance rankings and it had the second highest number of customer complaints.

In early September 1998 the company warned analysts that its third-quarter earnings would fall short of the previous estimate of 61 cents per share due to "unsatisfactory operational performance". This prompted a 29% fall in its share price, which has now more than halved since April-May (well exceeding the general sharp decline in US airline stocks).

America West is now expected to merely match last year's third-quarter earnings of 40 cents per share. Solving the problems must be an urgent priority to prevent the loss of hard fought-for business travellers. The First Call consensus estimate is that full-year 1998 profits will be up from last year's \$1.63 to \$2.29 per share (about \$110m).

Why the operational problems?

The airline blames many of the problems on the lengthy FAA investigation, which resulted in the agency imposing a record \$5m fine in July for maintenance and operating violations (half of the amount will be waived subject to compliance). The violations included operating 17 A320s that were overdue for major structural inspections, although airworthiness or safety were apparently not compromised. America West says that the



efforts to implement new practices and make sure that correct procedures were followed led to many flight delays.

The management also cited bad weather and "protracted and difficult negotiations" with the Teamsters' union, which represents the airline's 450 mechanics, as reasons for the operational problems. The union says that there never was an organised work slowdown, but rallies were held against job outsourcing. Relations with both the mechanics and flight attendants have been turbulent and the contract talks with both unions have been under federal mediation.

The unions, in turn, have blamed the management for excessive cost-cutting, too frequent operations staff changes and bad management generally. The leadership, led by chairman William Franke, who steered the company through Chapter 11, and president/CEO Richard Goodmanson, has accepted responsibility for the concerns raised by the FAA and other matters, as they have also come under some criticism from analysts.

America West's labour problems and poor morale date back to the Chapter 11 filing in 1991, when workers saw their shareholding wiped out. Franke's confrontational leadership style then led to unionisation efforts, though workers have given him credit for bringing in new management talent. The decision to outsource heavy maintenance led

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to a bitter dispute with the mechanics, who elected to be represented by the Teamsters in April 1996.

Ongoing projects such as upgrading computer systems and improving training may improve morale and help restore operational reliability, but the only real solution is to secure contracts with the unions. As a major breakthrough development, management and the Teamsters reached tentative agreement on their first-ever contract on September 20.

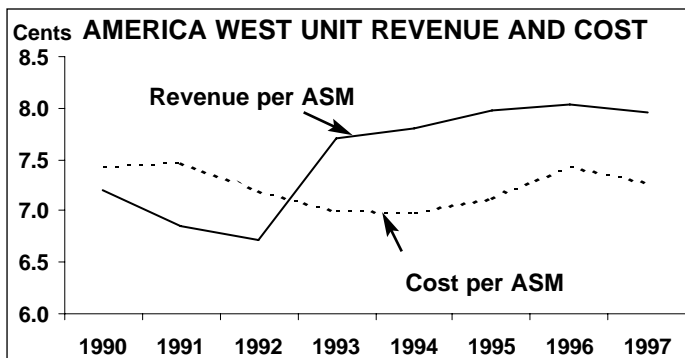
Fleet plans

The Chapter 11 restructuring, which included the elimination of 747s and Dash-8s, gave America West a fleet that was basically well-matched to its needs but needed some fine-tuning. The only major change so far has been the addition of A320s with more powerful engines, to supplement the earlier leased A320-200s that incur payload/range penalties when operated from the Phoenix hub in high temperatures.

The current 106-strong fleet includes 13 757-200s, 29 A320s, 46 737-300s and 18 older-generation 737s. The first A319 is due to join the fleet this month (October) and two more are scheduled to arrive by year-end.

In September 1997 America West finally announced the restructuring and expansion of its earlier Airbus order, making a firm commitment to purchase 22 A319-100s and 12 A320-200s, valued at \$1.4bn. The new arrangements secured lower prices and financing assistance. Deliveries began earlier this year and will continue through 2000.

The new deal provides much flexibility, enabling the carrier to either maintain a relatively stable size or grow if opportunities materialise. Another 12 A320s are subject to reconfirmation.



There are options on 40 aircraft of the A320 family, for delivery in 2001-2005, and certain rights to convert firmly ordered A319s and A320s to the larger A321.

Route expansion strategy

In the autumn of 1995 America West embarked on a "two-year flexible growth strategy" to rebuild its Phoenix and Las Vegas hubs, which had shrunk since the Chapter 11 filing in 1991. The plan was to increase ASMs by 29% and total departures by 17% by adding service to eight new cities and introducing twice as many non-stops from Phoenix as its closest competitor.

Consequently, in 1996 America West was one of the fastest-growing major airlines, adding eight aircraft to its fleet and recording an 11.3% increase in ASMs. But the combination of a sharp hike in aircraft leasing costs and operational reliability problems prompted the carrier to scale back its plans. Yet its capacity still rose by 9% in 1997.

Over the past year, America West has focused on trying to increase its local hub market share and the proportion of high-yield business traffic. It has also spent much time developing better schedules. Its previous strategy of operating low frequencies meant that it lacked dominance in any market. The new emphasis is on frequency, better times and key cities.

There has been a major focus on boosting service from Phoenix and Las Vegas to the East coast business centres of Boston, Washington (Dulles), Baltimore, Philadelphia and Newark. The summer schedule included seven daily flights to New York from Phoenix and three to most of the other cities. Services to the Pacific Northwest, California and Florida from the two main hubs have also been expanded. The Las Vegas night flights operation has been restructured to improve arrival times.

The mini-hub at Columbus (Ohio) has been strengthened with new services to Florida. The fourth quarter will see substantial expansion at Columbus, from 29 to 37 daily flights, and more convenient schedules on numerous business-oriented routes.

The acquisition of five new slots at Chicago O'Hare and additional A320 deliveries will enable the airline to boost its Phoenix-Chicago frequencies in October (from the present three to six daily flights by January 1999).

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America West's long-standing regional partner Mesa Airlines will also feature in the expansion plans. The deal came briefly under threat in March 1998, after Mesa defaulted on the contract by failing to reach a completion factor of 97%, but a new six-year agreement on expanded co-operation was signed in July.

Mesa currently operates as America West Express out of Phoenix to 17 cities in Arizona, New Mexico, Iowa, Colorado and California. The new agreement will expand co-operation to additional points in those states, northern Mexico and the Las Vegas and Columbus hubs.

Most of the routes will be served by Mesa's 50-seat CRJs and 37-seat Dash-8s, replacing many of the 19-seat Beech 1900s that have in the past been the mainstay of the America West Express fleet. The new agreement stipulates growth in the size of the CRJ and Dash-8 fleets to 12 and 14 respectively by the end of 1999, with options for further growth in 2000-2001. The longer ranges of those types will allow expansion to new markets "throughout the US and northern Mexico".

Position vis-à-vis alliances

America West's strategic alliances with Continental and Mesa, as well as its codeshare agreement with Northwest, were all put in place by the Chapter 11 reorganisation process. Continental and Mesa were investors in AmWest Partners, which provided the \$214.9m cash investment in 1994.

The codeshare arrangement with Continental, which began in October 1994 and has been expanded in stages, is the largest of its kind ever implemented in the US. The two have also consolidated ground handling and customer service functions at a large number of airports.

The actual revenue benefits derived from the Continental alliance are believed to be fairly modest - probably well below the \$40m annually to America West envisaged initially. But the long-standing links with Continental and Northwest must have effectively secured America West's long term strategic position in a future domestic marketplace possibly dominated by a few mega-alliances.

As an indication of things to come, America West was one of the four US airline signatories in a marketing and codeshare agreement forged

with Air China in May 1998 (the others were Continental, Northwest and Alaska). America West's role will be to provide connecting service between its Phoenix and Las Vegas hubs and the West coast. A similar (but independent) agreement with Taiwan's EVA was signed in April.

America West and British Airways have code-shared and had FFP links since July 1997, when BA began serving Phoenix from London. The initial co-operation was so successful that late last year the agreement was expanded to include America West's Las Vegas and Columbus hubs (linking them to BA's services to Los Angeles, San Francisco and Philadelphia).

Labour challenges

America West was fortunate in securing a five-year contract with its pilots in May 1995 that included an immediate 16% pay rise but also significant productivity improvements. But ratification had to wait for agreement on the issue of computerised pilot scheduling, which was finally reached in August 1998.

Dispatchers, represented by TWU, ratified a five-year contract in April this year that included pay increases, productivity improvements and flexible work rules. And over the past year, two labour groups - fleet-service workers and stock clerks - have actually rejected bids by TWU and the Teamsters to organise them.

But securing initial contracts with the mechanics (Teamsters) and flight attendants (AFA) has proved challenging. A breakthrough with the Teamsters came on September 20, when the two sides reached tentative agreement on a five-year contract. The deal is believed to include an immediate 14.4% wage increase, an additional rise of up to 34% over five years and, significantly, the recall of 375 mechanics laid off three years ago. As a major policy reversal - no doubt influenced by the re-emergence of operational problems - the company seems to have agreed to bring some heavy maintenance work back in-house.

The biggest remaining challenge is to sign with the 2000-plus flight attendants, who late last year overwhelmingly rejected a tentative five-year contract agreed to by the union's board. The two sides are believed to be far apart, but being the last remaining labour group without a contract puts some pressure on the flight attendants.

By Heini Nuutinen

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Stockholm the key to Finnair's future

As Finnair celebrates its 75th anniversary and prepares for privatisation in 1999, the airline is entering a crucial period. The airline's strategy is clear - to mount an aggressive attack into Stockholm Arlanda, its arch-rival's backyard. But will Finnair's gamble work?

At first glance Finnair appears to be doing remarkably well. Finnair serves 21 domestic and around 50 international scheduled destinations, including North America (New York, Miami, San Francisco, Toronto) and the Asia/Pacific region (Singapore, Bangkok, Tokyo, Beijing, Osaka). In addition the airline has substantial leisure market business - of the total 7.1m passengers flown by Finnair in 1997/98 (a 12.5% increase on 1996/97) charter flights accounted for 11%. And Finnair recorded net profits of FM510m (\$95m) in 1997/98, 58% up on 1996/97, with a net profit margin of 6.3% (compared with 4.4% in 1996/97).

However, 1997/98 may prove to be Finnair's peak in the 1990s. Finnair's management forecasts that "because of tough competition financial results for the current year may fall short of those for 1997/98". Yields have already fallen 10% in the last four years, and operating profit was flat in the first quarter of 1998/99 (April-June 1998)

despite an increase in passengers carried of 9.7%.

The main reason for sluggish results in 1998 is SAS and the Star alliance. The Nordic market (Scandinavia, the Baltic states and Finland) covers 30m people but within that Finland is relatively isolated geographically. Finland is a small niche market, and Finnair cannot rely on that demand alone.

The key hub in the region is not Helsinki-Vantaa but Stockholm-Arlanda, which is the second-fastest growing airport for international departures in Europe (see graph, page 17). The airport has therefore become a key battleground between Finnair, which wants to set up a major operation there, and SAS - which not surprisingly considers Arlanda as "home territory".

Finnair's expansion into Stockholm has been substantial, although there is still a long way to go. Fifth-freedom operations at Stockholm accounted for 15% of Finnair's total international flights by the end of 1994 and 24% by the end of 1997. Traffic on Finnair's Sweden-third country services now surpasses passengers carried on its Helsinki-Stockholm route.

Today Finnair serves 20 destinations from Stockholm with approximately 50 flights per day, and the airline wants to operate further services in order to compete directly with SAS on even more routes to third countries.

Undoubtedly Stockholm is a more natural Nordic market link to eastern and southern Europe than is Helsinki, although "Finnish market feed from Helsinki is essential for Stockholm to be a real Nordic hub", says Antti Potila, Finnair's president and CEO. However, at present Finnair does not base any of its aircraft at Stockholm, although it is "looking at this very carefully", according to Potila. At the same time Finnair has also expanded Stockholm-Helsinki services.

FINNAIR FLEET PLANS

	Current fleet	Orders (options)	Delivery/retirement schedule/notes
757-200	4	0	All leased and used for charter flights. A fifth 757 will be leased in April 1999.
DC-9-51	12	0	Being hushkitted
MD-11	4	0	
MD-80	25	0	12 on lease.
A300	2	0	Leased out
A319	0	5	2 in 1999, 3 in 2000
A320	0	3 (24)	3 in 2000. Options are for A320 family aircraft.
A321	0	4	2 in 1999, 2 in 2000
Saab 340	6	0	3 on lease
ATR-72	6	0 (2)	1 on lease
TOTAL	57	12 (26)	

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Inevitably, SAS has not taken too kindly to Finnair's strategic move. Lufthansa's code now appears on SAS flights from Copenhagen, Stockholm and Oslo to Helsinki while SAS's code appear on Lufthansa flights from Frankfurt to Helsinki.

But Finnair codeshares with Braathens on Oslo/Stockholm, while Maersk and Finnair have codeshared on Copenhagen/Stockholm since April 1997. On the latter route (which carries 1m passengers per year) Finnair/Maersk's business fares are more than 25% below SAS's prices, and the codesharing deal is set to run for the next six years following approval from the European Commission.

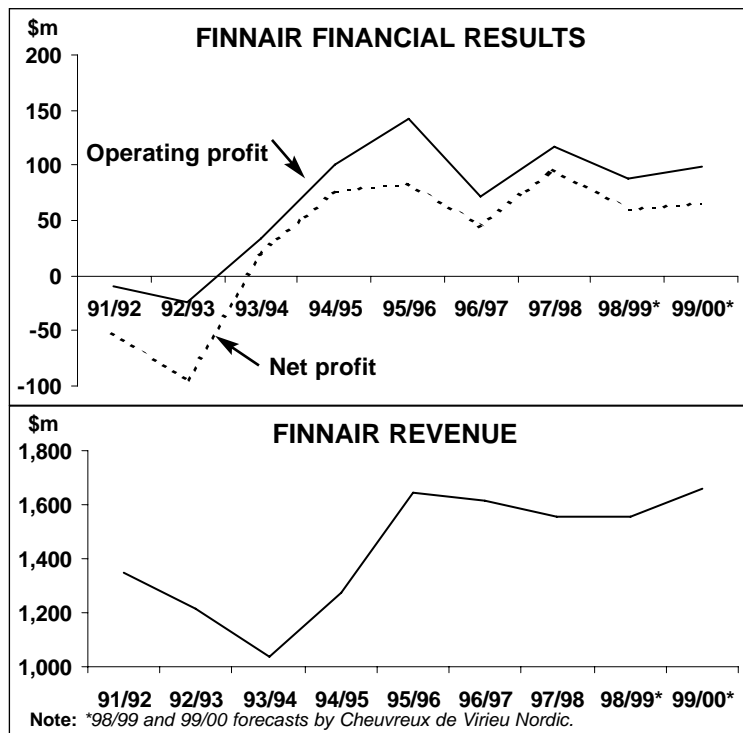
The SAS empire strikes back

However, while Finnair is making some headway into traditional SAS strongholds, SAS is striking back via the domestic Finnish market, which accounts for 40% of the total scheduled passengers carried by Finnair, and 15% of revenue. In 1992 Finnair faced competition on just three domestic routes, but a combination of deregulation and SAS's acquisition of Finnish airline Air Botnia in January 1998 has overturned the status quo of the last domestic market in Europe with virtually zero competition.

Air Botnia now operates on seven of the eight largest domestic routes in Finland (the exception being Helsinki/Oulu, the busiest route), and SAS intends to add more turbo-props to Air Botnia's fleet. And SAS is also considering new routes to Finnish provincial towns, to add to the estimated 25% market share of international routes to/from Finland that SAS and Lufthansa already have.

SAS's proxy airline in Finland is a severe threat to Finnair. Some analysts feel that Finland's isolation is a key strength for Finnair - Cheuvreux de Virieu Nordic comments: "Finland ... is not a market where the global companies feel the need for market share".

However, the very smallness of the Finnish market (even though the domestic economy is strong) is also a key weakness of Finnair and means that that the airline *has* to expand into other Nordic markets - and



that means encroaching on SAS. Inevitably that has resulted in SAS's foray into Finland itself.

Strategically however, that is a risk that Finnair has to take. And Finnair knows that it is taking on not just SAS but the entire Star alliance - Air Botnia, for example, also provides feed to Lufthansa, with whom Finnair ended a six-year old co-operation agreement in October 1997.

The logical consequence of taking on the Star alliance is that Finnair had to align itself with one of the other global alliances. According to Finnair, 14 codeshare agreements and nine seat purchasing agreements brought in FM209m (\$40m) in 1997/98, representing 3.5% of air transport revenue. However, these agreements are minor compared with the potential of Finnair's chosen global alliance - the British Airways/American grouping.

The "Nordic Alliance" with BA, agreed in February this year, includes codesharing between London, Manchester, Helsinki and Stockholm, as well as joint marketing and FFPs. Finnair will also join the full oneworld alliance. Finnair intends to leave its North America partner, Delta, as soon as possible

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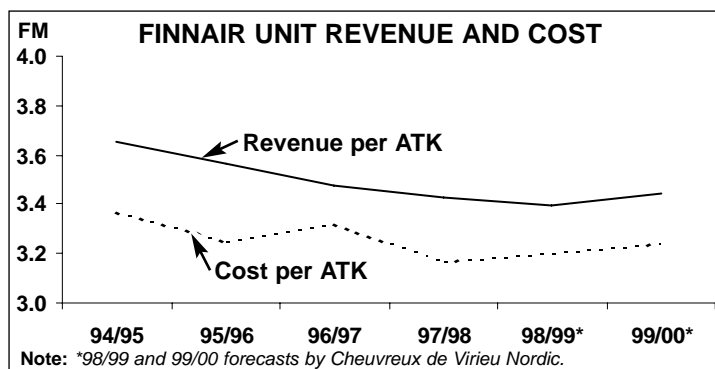
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so that it can ally with American in March 1999, ready for the 1999 summer timetable. In March this year Finnair signed a code-sharing agreement with LOT, and Finnair also has a codeshare agreement with Iberia, in which BA is negotiating to buy a minority share.

What Finnair offers British Airways is northern European feed as well as a potential hub (Stockholm) for long-haul flights to the Asia/Pacific region on the transpolar route - although Potila says that "at present that is not feasible since our widebodies have to be serviced at Helsinki". Just as importantly, an alignment with the British Airways grouping gives a psychological level of protection for Finnair.

The British Airways deal will also make up for revenue lost to/from Russia. Cheuvreux de Virieu Nordic estimates that the Russian crisis will knock \$16m off Finnair's 1998/99 profits. As for the Asian crisis, Finnair enjoys some protection since most of its long-haul passengers originate in Finland and not in the Asia/Pacific region itself. However, the airline does carry a significant amount of cargo to Asia, which will be hit.

But Finnair has powerful allies elsewhere in its battle with SAS. KLM too is challenging SAS - while SAS controls Air Botnia, Cimber Air and Wideroe, KLM partner Braathens has bought Malmo Aviation, the last non-aligned carrier in Sweden. And from last month (September) Finnair extended a codesharing agreement with Sabena to five flights a day on Brussels-Stockholm and two a day on Brussels-Helsinki. This also brings Finnair closer to the Swissair/Sabena/Austrian camp.



Maintaining a margin

As can be seen in the graph below, unit revenues are declining and so cost-cutting is vital for Finnair.

At the start of 1997/98 Finnair launched a cost-cutting and productivity improvement programme called Programme 2. This aims to improve the bottom line by FM500m (\$96m) over a three year period, and according to Finnair the programme is on target so far. However, even if Programme 2 is successful, Finnair's profits will just stand still, as the FM500m improvement will merely offset an estimated FM500m erosion in profits over the next three years anyway due to increasing competition, according to Potila.

Programme 2 does not include personnel and Finnair is now also looking at this area, including the possible introduction of performance-related pay. However, union relations have not been great. Although a two-year collective agreement was signed with most staff in December 1997, pilots were not part of the deal.

After Finnair absorbed domestic subsidiaries Karair and Finnaviation in 1997 an attempt to standardise working conditions was strongly resisted by pilots, eventually leading to work-to-rule action and flight cancellations in March-May 1998. Although 530 jet pilots reached a deal with Finnair "along the lines of other labour agreements within the airline" in April 1998, the airline is still in dispute with 58 turboprop pilots at the former domestic subsidiaries. Potila states that "talks are continuing, and a settlement should be reached before the end of the year". Finnair's pilots are part of the Alliance Coalition, the grouping formed by pilot unions at 11 airlines in August 1998.

With 10 different aircraft types, Finnair's fleet is not the most cost-effective. Although its 12 DC-9-51s have an average age of more than 20 years, last month (September) Finnair started refitting and hushkitting them at a cost of \$2.5m each. This will extend their life by 5-6 years. A few DC-9-51s may be sold, but the rest will remain in service.

The MD-80s (some of which were sold and leased back in 1997) will be replaced by A320 family aircraft in 1999-2001 at a cost of

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FM2.2bn (\$424m). Finnair should be able to finance this via cash flow and a relatively small increase in gearing. Further A320 family orders are likely. Finnair is also considering extra MD-11s for its long-haul fleet. And a fifth leased 757 for charter operations will arrive in April 1999. A question mark, however, remains over the future of the turboprop fleet. Domestic load factor was just 58.1% in 1997/98, and even if/when a deal with the turboprop pilots is completed, Finnair may have to contemplate franchising.

Other than personnel and aircraft, the other cost-cutting option for Finnair is outsourcing, such as maintenance, for example. This is an alternative that Finnair may have to explore given the likely cost pressures from factors outside its control. Fuel prices can only increase and the airline will continue to suffer from the Markka's weakening against the Dollar (which is forecast to continue, according to the OECD).

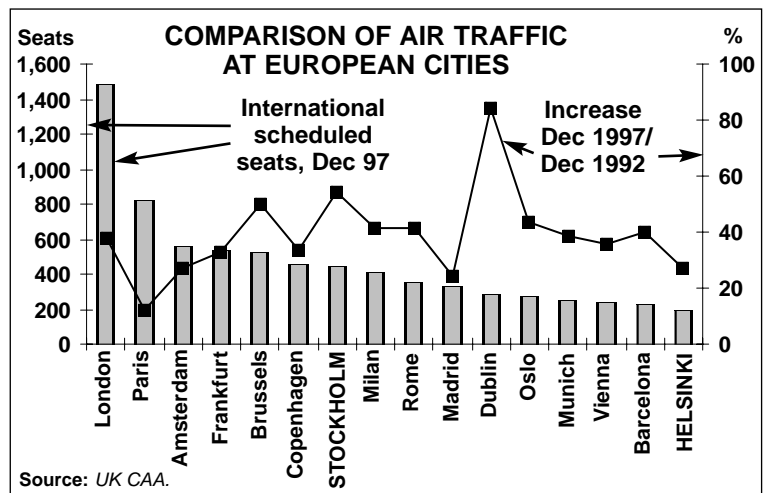
Pre-millennium privatisation

The Finnish government first obtained a majority shareholding in Finnair in 1946, and it still owns 59.5% of the airline today. (Finnair is listed on the Helsinki stock exchange.) At present, the stockmarket is applying a substantial discount to Finnair stock. The PE/ratio for Finnair is 9, compared with an average of 13 for all other quoted European airlines.

Full privatisation is tentatively scheduled for 1999 as part of the coalition Finnish government's intention to sell "non-core assets". The likely timeframe is after parliamentary elections in March 1999, with the government possibly retaining a small stake.

Senior executives in Finnair are in favour of privatisation, although some believe the airline could continue quite successfully with majority state ownership. "It's good to have one large shareholder" says Potila, "whoever that is".

How successful the sale of the government's stake will be may depend on how far Finnair penetrates into Stockholm. Finnair's strategy of expanding into the Nordic market by attacking SAS at Arlanda is fraught with danger, as it is provoking an SAS attack into



the domestic market. Yet Finnair has little choice, because if it stayed in its home market it's likely that SAS or Lufthansa would have challenged it there anyway in time. Potila says: "We decided that instead of desperately defending 100% market share in Finland, it would make more sense to win share elsewhere."

But even if it does establish itself at Stockholm (and to do that it will have to base a substantial part of its fleet there), Finnair is still a niche carrier - and as such it had to have the insurance of "signing up" with a global alliance. British Airways was the obvious choice, but in many respects at present Finnair needs BA more than BA needs Finnair, at least until Finnair can deliver a beefed-up Stockholm operation.

Once Finnair is privatised, if it wants to it will be free to pursue much closer links - possibly including equity - with BA than are possible now (due to the current government stake). That may be Finnair's salvation long-term, and this will be one of the most important decisions that Keijo Suila, who takes over as president and CEO from Antti Potila in January 1999, will have to take.

On the other hand, Finnair - like all other small members of alliances - must be careful that it isn't exploited by the likes of BA and AA. But if Finnair can upgrade its foothold at Arlanda into a substantial hub operation for the Nordic region, then the airline will have something really concrete with which to hook BA and the oneworld alliance long-term.

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Management

How to manage commuter feed airlines

Commuter airline affiliations are becoming increasingly problematical for the major jet carriers. In this article Louis Gialloredo of McGill University takes a look at the strategic options available to large jet airlines when managing their commuter affiliates.

For most airlines, the original rationale for connector or regional airline affiliation is threefold:

- 1) Incremental traffic feed revenue; and/or
- 2) Downloading routes (city-pairs) that are more cost effective when served by an affiliated regional airline with much lower costs/seat mile than the mainline jet airline partner; and/or
- 3) Experimenting on new thin city-pair markets to see whether or not these can be grown into trunkline jet routes.

A rather simplistic market access or protection strategy was first deployed by USAir. Linking the USAir commuter group services (Allegheny or Piedmont etc) to USAir's rather expensive jet operations in what were mostly monopoly northeast US city pairs locked up feed and therefore market share and geographic predominance. Many other US trunk airlines quickly adopted the same strategy as USAir in the late 1970s and early 1980s.

Other national markets such as Canada, Australia and New Zealand also became ideal proving grounds into which the majors could deploy commuter affiliates, due to large territorial expanse, limited population density and limited national jet airline competition, all mixed in with some form of deregulation. As long as markets were growing and deregulation forced re-allocation of city pairs then all was well.

In fact, things went so well that the value of feeder networks became very significant. At this point many of the regional airline pups - most of which were still independently owned - began thinking of how to best maximise shareholder value.

In the US this inevitably led to commuter groups being willing to affiliate and re-affiliate with the highest bidder jet trunk airline. This musical chairs approach to feeder relationships led to two main effects - the Majors now faced a new element of competition when securing feed, while customers trying to follow the codeshare trail became increasingly annoyed at the constant changing of the trunk airlines' feeders.

Buying-out the problem

There was a simple way to defend an airline against the threat of constant feeder change - to buy majority stakes in the commuter or gaggle of commuter groups a carrier wished to lock-up. In the mid-1980s this became the strategy of choice in North America.

This strategy did, however, produce some unwanted consequences for the trunk airlines. First, the cost of the feed - when one counted variable and now capital expense of ownership - rose significantly.

Second, organised labour was not keen, to say the least. The jet airline unions were upset that that flying/mechanical work was being outsourced to regionals, while the regional airline unions eventually got tired of flying short hops in bad weather for much less pay than their jet comrades. Thus airline managements faced a squeeze from either side - from jet unions pushing for compensation for work they gave up without agreement to the regionals, and from the regional unions pushing for equality of wage with the jet parent workers.

Why, one might ask, have the Majors put up with these cost and labour problems and tolerated increasingly expensive solutions to their grassroots network feed requirements?

The simple answer is that the aviation cycle often disguises the problems of costly commuter feed. In an upturn, jet airlines

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Management

increasingly compete for market share - and thus want as much feed as possible - while in a downturn lay-offs and the like seem to have a quieting effect on labour unions.

But whether in upturn or downturn, the absolute cost of running the regional commuter affiliates rises gradually, but surely, to the point where the gap between major airlines and majority-owned commuter affiliate carriers shrinks beyond the level of even semi-effective returns. Then the issue becomes one of divestiture or outright closure/rationalisation of services back under one, now cheaper, organisational umbrella.

Usually the parent airline loses money on its original investment because if it closes the regional any shareholder value disappears, while if it tries to re-sell the commuter without the codeshare and attendant link-ups (FFP, CRS etc) this means that the newly independent commuter is worth a fraction of its previous value.

Inaction, however, is now not an option for airline managements because of two factors. First, aircraft technology has moved regional jets into the 35-70 seat range, previously the reserve of the turboprops. This has further blurred the lines between labour at trunk jet operations and the regional commuter airlines, and in addition these regional jets have forced a rediscussion on hub versus point-to-point network design.

Second, the last downturn forced many of the major airlines in North America to sell off pieces of their wholly-owned regional carriers, whether they wanted to or not.

A third strategy?

So, do airlines have an alternative to traditional commuter feeder networks or buying their own commuters? If an airline has its own majority-owned feeder the starting-point is what to do with this carrier. As it becomes cost-ineffective one possibility is for the feeder to be *gradually* wound down. This can be achieved by pushing larger routes up to the mainline jet network while creating a new "grassroots" feeder underneath the current regional by transferring smaller, thinner

volume routes to a new lowest-cost (non-equity) partner.

However, the grassroots partner need not work exclusively for one jet airline. For example, at Mesa one operator provided feeder operations for many different partners based on geographically delineated territories.

Indeed, as the jet airline will be operating the larger feeder routes itself, the smaller, thinner routes may be dispersed and it would be unlikely that one feeder could serve them all.

Under this strategy, as routes are transferred up into the main jet operation or passed to a grassroots feeder, over time the cost-bloated mid-range commuter airline is reduced in size and can either be spun-off or collapsed with minimal damage to the major airline brand.

Three evolving strategies

The US experience has shown that it takes about two deregulated cycles (about 10-15 years) for feeder network competitiveness to start becoming critical, with three evolving strategies for commuter feed management:

- 1) A brand-franchise premised, non-equity-based management of constantly evolving groups of operators that are contractually managed to optimise feed revenue to the trunk airline.
- 2) A constant building and rebuilding of a trunk airline's own majority-owned commuter network and airline partners.
- 3) A development of self-standing non-major airline affiliated commuters, premised on point-to-point non-network linked route systems.

This third strategy, however, may be a leap too far for many airlines. Recent difficulties at Mesa, as well as a very slow evolution of a self-standing commuter/regional group, may indicate that the first two strategies will remain the most frequently used options at the major jet airlines.

This may be a missed opportunity, as the third strategy has plenty of potential for a new kind of relationship between trunk airline and commuter feed carrier.

Aviation Strategy

Macro-trends

EUROPEAN SCHEDULED TRAFFIC

	Intra-Europe			North Atlantic			Europe-Far East			Total long-haul			Total international		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
1991	114.8	65.2	56.8	120.9	84.3	69.7	80.0	53.1	66.4	267.6	182.0	68.0	397.8	257.9	64.7
1992	129.6	73.5	56.7	134.5	95.0	70.6	89.4	61.6	68.9	296.8	207.1	69.8	445.8	293.4	65.8
1993	137.8	79.8	57.9	145.1	102.0	70.3	96.3	68.1	70.7	319.1	223.7	70.1	479.7	318.0	66.3
1994	144.7	87.7	60.6	150.3	108.8	72.4	102.8	76.1	74.0	334.0	243.6	72.9	503.7	346.7	68.8
1995	154.8	94.9	61.3	154.1	117.6	76.3	111.1	81.1	73.0	362.6	269.5	74.3	532.8	373.7	70.1
1996	165.1	100.8	61.1	163.9	126.4	77.1	121.1	88.8	73.3	391.9	292.8	74.7	583.5	410.9	70.4
1997	174.8	110.9	63.4	176.5	138.2	78.3	130.4	96.9	74.3	419.0	320.5	76.5	621.9	450.2	72.4
July 98	17.1	11.8	68.9	18.5	15.3	82.4	11.7	8.9	75.9	41.1	32.7	79.5	61.0	46.3	76.0
Ann. chng	8.9%	8.7%	-0.1	10.6%	9.0%	-1.2	5.0%	1.2%	-2.8	8.9%	6.8%	-1.6	9.2%	7.4%	-1.2
Jan-Jul 98	107.5	68.2	63.5	109.1	84.2	77.2	78.4	57.3	73.1	257.9	194.5	75.4	383.0	273.8	71.5
Ann. chng	7.5%	9.4%	1.1	9.3%	8.0%	-0.9	6.2%	3.8%	-1.7	8.7%	7.3%	-1.0	8.4%	7.6%	-0.5

Source: AEA.

US MAJORS' SCHEDULED TRAFFIC

	Domestic			North Atlantic			Pacific			Latin America			Total international		
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %
1990	863.1	523.2	60.6	121.3	84.2	69.4	106.7	75.8	71.0	42.2	26.6	63.0	270.2	186.5	69.0
1991	835.1	512.7	61.4	108.0	75.2	69.6	117.0	78.5	67.1	44.3	27.4	61.8	269.2	181.0	67.2
1992	857.8	536.9	62.6	134.4	92.4	68.7	123.1	85.0	69.0	48.0	27.4	57.0	305.4	204.7	67.0
1993	867.7	538.5	62.1	140.3	97.0	69.2	112.5	79.7	70.8	55.8	32.5	58.2	308.7	209.2	67.8
1994	886.9	575.6	64.9	136.1	99.5	73.0	107.3	78.2	72.9	56.8	35.2	62.0	300.3	212.9	70.9
1995	900.4	591.4	65.7	130.4	98.5	75.6	114.3	83.7	73.2	62.1	39.1	63.0	306.7	221.3	72.1
1996	925.7	634.4	68.5	132.6	101.9	76.8	118.0	89.2	75.6	66.1	42.3	64.0	316.7	233.3	73.7
1997	953.3	663.7	69.6	138.1	108.9	78.9	122.0	91.2	74.7	71.3	46.4	65.1	331.2	246.5	74.4
July 98	83.9	63.4	76.6										31.8	24.2	76.2
Ann. chng	0.7%	3.0%	1.7										6.3%	4.5%	-1.1
Jan-Jul 98	557.1	395.8	71.0										202.3	147.7	73.0
Ann. chng	0.7%	2.3%	1.1										6.8%	4.8%	-1.4

Note: US Majors = American, Alaska, Am. West, Continental, Delta, NWA, Southwest, TWA, United, USAir. Source: Airlines, ESG.

ICAO WORLD TRAFFIC AND ESG FORECAST

	Domestic			International			Total			Domestic growth rate		International growth rate		Total growth rate	
	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK bn	RPK bn	LF %	ASK %	RPK %	ASK %	RPK %	ASK %	RPK %
1991	1,267	800	63.2	1,487	998	67.1	2,754	1,798	65.3	-0.3	0.6	-2.6	-6.1	-1.6	-3.2
1992	1,300	840	64.6	1,711	1,149	67.2	3,011	1,989	66.1	2.7	5.0	15.0	15.2	9.4	10.7
1993	1,347	856	63.6	1,790	1,209	67.5	3,137	2,065	65.8	3.6	1.9	4.6	5.2	4.2	3.8
1994	1,403	924	65.8	1,930	1,326	68.7	3,333	2,250	67.5	4.2	7.9	7.8	9.7	6.3	9.0
1995	1,477	980	66.3	2,044	1,424	69.7	3,521	2,404	68.3	5.3	6.1	5.9	7.4	5.6	6.9
1996	1,526	1,046	68.6	2,163	1,537	71.1	3,689	2,583	70.0	3.3	6.7	5.8	7.9	4.8	7.4
1997	1,617	1,102	68.2	2,387	1,704	71.4	4,004	2,807	70.1	4.6	5.5	7.6	9.1	6.4	7.7
*1998	1,624	1,122	69.1	2,470	1,751	70.9	4,094	2,873	70.2	0.4	1.8	3.5	2.7	2.3	2.4
*1999	1,675	1,155	69.0	2,586	1,833	70.9	4,261	2,988	70.1	3.2	3.0	4.7	4.7	4.1	4.0
*2000	1,738	1,194	68.7	2,729	1,930	70.7	4,467	3,124	69.9	3.7	3.3	5.5	5.3	4.8	4.5
*2001	1,791	1,218	68.0	2,857	2,004	70.1	4,648	3,222	69.3	3.1	2.0	4.7	3.8	4.0	3.1
*2002	1,806	1,210	67.0	2,916	2,015	69.1	4,722	3,225	68.3	0.8	-0.7	2.1	0.6	1.6	0.1
*2003	1,857	1,273	68.5	3,066	2,165	70.6	4,923	3,437	69.8	2.9	5.2	5.1	7.4	4.3	6.6

Note: * = Forecast; ICAO traffic includes charters. Source: Airline Monitor, July 1998.

DEMAND TRENDS (1990=100)

	Real GDP					Real exports					Real imports				
	US	UK	Germany	France	Japan	US	UK	Germany	France	Japan	US	UK	Germany	France	Japan
1991	99	98	101	101	104	106	99	112	104	105	99	95	113	103	97
1992	102	98	102	102	105	113	103	112	109	110	107	101	115	104	96
1993	105	100	100	101	105	117	107	106	109	112	117	104	108	101	96
1994	109	103	103	104	106	126	117	115	115	117	131	110	117	107	104
1995	111	106	105	106	107	137	126	122	123	123	141	115	124	113	119
1996	114	108	107	107	111	152	135	128	128	126	155	124	127	116	132
1997	118	112	110	109	112	172	146	142	142	138	177	135	136	123	132
*1998	121	113	113	113	112	180	154	155	154	145	200	148	146	133	130
*1999	124	115	116	116	113	189	160	166	163	155	219	156	156	141	133

Note: * = Forecast; Real = inflation adjusted. Source: OECD Economic Outlook, June 1998.

Aviation Strategy

Macro-trends

COST INDICES (1990=100)

	Europe						US					
	Unit revenue	Unit op. cost	Unit lab. cost	Efficiency	Av. lab. cost	Unit fuel cost	Unit revenue	Unit op. cost	Unit lab. cost	Efficiency	Av. lab. cost	Unit fuel cost
1991	106	109	103	105	108	88	100	102	102	101	103	84
1992	99	103	96	119	114	80	98	100	101	107	108	75
1993	100	100	90	133	118	82	101	98	99	116	115	67
1994	100	98	87	142	123	71	98	94	101	124	125	62
1995	99	97	86	151	128	67	99	93	98	129	127	61
1996	100	101	88	155	135	80	102	94	98	129	126	72
1997	102	105	85	148	131	81	104	94	100	129	129	69
*1998	107	105	84	151	127	71	108	96	106	127	134	61

Note: * = First-half year. European indices = weighted average of BA, Lufthansa and KLM. US indices = American, Delta, United and Southwest. Unit revenue = airline revenue per ATK. Unit operating cost = cost per ATK. Unit labour cost = salary, social charges and pension costs per ATK. Efficiency = ATKs per employee. Average labour cost = salary, social costs and pension cost per employee. Unit fuel cost = fuel expenditure and taxes per ATK.

FINANCIAL TRENDS (1990=100)

	Inflation (1990=100)					Exchange rates (against US\$)						LIBOR 6 month Euro-\$	
	US	UK	Germany	France	Japan	UK	Germ.	France	Switz.	ECU	Japan		
1990	100	100	100	100	100	1990	0.563	1.616	5.446	1.389	0.788	144.8	8.27%
1991	104	106	104	103	103	1991	0.567	1.659	5.641	1.434	0.809	134.5	5.91%
1992	107	107	109	106	105	1992	0.570	1.562	5.294	1.406	0.773	126.7	3.84%
1993	111	109	114	108	106	1993	0.666	1.653	5.662	1.477	0.854	111.2	3.36%
1994	113	109	117	110	107	1994	0.653	1.623	5.552	1.367	0.843	102.2	5.06%
1995	117	112	119	112	107	1995	0.634	1.433	4.991	1.182	0.765	94.1	6.12%
1996	120	114	121	113	107	1996	0.641	1.505	5.116	1.236	0.788	108.8	4.48%
1997	122	117	123	114	108	1997	0.611	1.734	5.836	1.451	0.884	121.1	5.85%
*1998	123	119	125	116	109	Sep 1998	0.587	1.671	5.604	1.378	0.850	135.4	5.25%**
*1999	126	122	127	117	109								

Note: * = Forecast. **Source:** OECD Economic Outlook, June 1998. ** = \$ LIBOR BBA London interbank fixing six month rate.

JET AND TURBOPROP ORDERS

	Date	Buyer	Order	Price	Delivery	Other information/engines
ATR	Sep 11	Cimber Air	2 ATR 72-500s		1Q99+	+ 2 options
	Sep 7	Oman Air	2 ATR 42-500s	\$90m	4Q98-99	+ 4 options
Airbus	Sep 10	debis AirFinance	2 A319s			V2500
	Sep 9	GECAS	30 A320 family		2Q03-06	+ 10 options
	Sep 9	UPS	30 A300F4-600Rs		00+	+ 30 options
	Sep 8	Emirates	6 A340-500s		3Q02-03	+ 10 options
	Sep 8	ILFC	10 A340-5/600s, 6 A320 family		02-06	
BAe	Sep 9	Flightlease	3 RJ100s	\$80m	2Q-3Q99	
Boeing	Sep 25	Lufthansa	6 MD-11Fs			3 from options
	Sep 11	Hapag-Lloyd	5 737-800s		01-02	From options
	Sep 9	SAS	14 737-6/7/800s	\$600m		9 from options
	Sep 9	Cronus Airlines	1 737-700	\$90m	01	+ 1 option
	Sep 9	GATX	5 737-800s	\$260m		
	Sep 9	GECAS	9 767-300ERs,			
			3 767-400ERs	\$1,270m	99-02	
	Sep 8	Varig	4 737-700s, 10 737-800s			
			4 777s, 6 767-300ERs	\$2.7bn (inc. opts)		+ 4 777-200 and 11 737-700 options
	Sep 7	ILFC	9 737-800s, 1 767-300ER,			
			6 757-200s, 1 777-200ER	\$1.2bn	99+	
	Sep 7	KLM	4 737-900s	\$230m	2Q-3Q01	
Bombardier	Sep 17	Lufthansa	10 CRJ-700s,			
			10 CRJ-100s	\$475m	1Q00-2Q02	+ 10 CRJ-700 options
	Sep 8	Atlantic Coast AL	10 CRJ-200ERs	\$200m	By 2Q02	From options
	Sep 4	Midway Airlines	7 CRJ-200ERs	\$148m	2Q99-4Q99	From options
	Sep 4	Atlantic Southeast	12 CRJ-700s,			
			15 CRJ-200s	\$575m	1Q00-1Q03	
Embraer	Sep 8	Eagle Air	75 ERJ-135s	\$2bn	3Q99-04	+ 75 options
	Sep 8	Continental Exp.	25 ERJ-145s	\$375m		From options
	Sep 8	Flandre Air	2 ERJ-135s			From options
	Sep 8	Nat. Jet Systems	2 ERJ-145s		4Q98	+ 2 options
	Sep 8	Luxair	5 ERJ-145s			
Fairchild Dornier	-	-	-			

Note: Prices in US\$. Only firm orders from identifiable airlines/lessors are included. MoUs/Lols are excluded. **Source:** Manufacturers.

Aviation Strategy

Micro-trends

	Group revenue	Group costs	Group operating profit	Group net profit	Total ASK	Total RPK	Load factor	Group rev. per total ASK	Group costs per total ASK	Total pax.	Total ATK	Total RTK	Load factor	Group employees
	US\$m	US\$m	US\$m	US\$m	m	m	%	Cents	Cents	000s	m	m	%	
American*														
Oct-Dec 96	3,967	3,751	216	284	62,503.6	42,194.2	67.5	6.35	6.00	19,528	9,366.1	4,969.5	53.1	91,476
Jan-Mar 97	4,006	3,782	224	152	62,059.4	41,676.0	67.2	6.46	6.09	19,363	9,283.2	4,848.4	52.2	86,246
Apr-Jun 97	4,292	3,812	480	302	64,026.0	45,012.1	70.3	6.70	5.95	20,697	9,482.2	5,241.2	55.3	87,248
Jul-Sep 97	4,377	3,868	509	323	65,093.0	46,943.3	72.1	6.72	5.94	21,343	9,637.3	5,406.0	56.1	87,793
Oct-Dec 97	4,228	3,871	357	208	63,308.3	42,715.7	67.5	6.68	6.11	19,681	9,366.9	5,025.2	53.6	88,302
Jan-Mar 98	4,223	3,798	425	290	62,405.4	41,846.6	67.1	6.77	6.09	19,267	9,207.0	4,889.4	53.1	87,569
Apr-Jun 98	4,491	3,885	606	409	64,471.8	46,075.9	71.5	6.97	6.03					87,250
America West														
Oct-Dec 96	440	415	25	12	9,272.8	6,405.0	69.1	4.75	4.48	4,620	1,162.4	688.1	59.2	10,866
Jan-Mar 97	475	442	33	14	9,318.8	6,408.6	68.8	5.10	4.74	4,590	1,168.8	686.7	58.8	11,422
Apr-Jun 97	478	427	51	23	9,410.5	6,668.9	70.9	5.08	4.54	4,674	1,180.1	712.8	60.4	11,690
Jul-Sep 97	462	425	37	18	9,623.6	6,779.9	70.5	4.80	4.42	4,692	1,205.8	724.3	60.1	11,506
Oct-Dec 97	473	432	41	20	9,573.7	6,219.9	65.0	4.94	4.51	4,375	1,200.4	670.1	55.8	11,232
Jan-Mar 98	483	434	49	25	9,408.0	5,851.4	62.2	5.13	4.61	4,149	1,180.7	630.2	53.4	11,329
Apr-Jun 98	534	457	77	41	9,787.8	6,899.1	70.5	5.46	4.67	4,643				11,810
Continental														
Oct-Dec 96	1,561	1,462	99	47	25,258.0	16,628.9	65.8	6.18	5.79	9,474	2,803.4	1,732.3	61.8	33,468
Jan-Mar 97	1,698	1,552	146	74	25,478.4	17,526.9	68.8	6.66	6.09	9,739	2,820.6	1,790.5	63.5	33,766
Apr-Jun 97	1,786	1,555	231	128	26,530.9	19,186.1	72.3	6.73	5.86	10,462	3,032.6	1,996.8	65.8	34,672
Jul-Sep 97	1,890	1,683	207	110	28,462.1	20,982.1	73.7	6.64	5.91	10,822	3,331.3	2,206.5	66.2	35,630
Oct-Dec 97	1,839	1,707	132	73	28,278.6	19,400.1	68.6	6.50	6.04	10,188	3,381.1	2,140.0	63.3	37,021
Jan-Mar 98	1,854	1,704	150	81	28,199.8	19,427.5	68.9	6.57	6.04	10,072	3,372.4	2,134.4	63.3	37,998
Apr-Jun 98	2,036	1,756	280	163	29,891.1	22,007.2	73.6	6.81	5.87	11,261				38,850
Delta														
Oct-Dec 96	3,197	2,970	227	125	55,030.0	37,664.1	68.4	5.81	5.40	24,625	7,606.7	4,420.7	58.1	63,862
Jan-Mar 97	3,420	3,074	346	189	54,214.1	37,334.2	68.9	6.31	5.67	24,573	7,489.7	4,354.8	58.1	67,851
Apr-Jun 97	3,541	3,022	519	301	55,604.5	41,457.2	74.6	6.37	5.43	26,617	7,777.3	4,798.9	61.7	69,118
Jul-Sep 97	3,552	3,121	431	254	57,424.7	42,783.2	74.5	6.19	5.43	26,478	8,112.8	4,946.2	61.0	69,502
Oct-Dec 97	3,433	3,101	332	190	56,177.4	38,854.9	69.2	6.11	5.52	25,464	7,941.4	4,639.6	58.4	69,982
Jan-Mar 98	3,389	3,053	336	195	54,782.3	39,602.7	68.7	6.19	5.57	24,572	7,766.6	4,448.9	57.3	71,962
Apr-Jun 98	3,760	3,165	595	362	57,175.5	43,502.6	76.1	6.58	5.54					75,000
Northwest														
Oct-Dec 96	2,340	2,265	75	26	37,216.7	26,054.6	70.0	6.29	6.09	12,723	5,965.7	3,566.9	59.8	47,631
Jan-Mar 97	2,376	2,241	135	65	37,102.1	26,702.1	72.0	6.40	6.04	12,661	5,800.7	3,471.3	59.8	47,628
Apr-Jun 97	2,558	2,267	291	136	38,985.3	29,195.9	74.9	6.56	5.82	13,780	6,175.7	3,817.3	61.8	48,025
Jul-Sep 97	2,801	2,298	504	290	41,491.3	32,231.1	77.7	6.75	5.54	14,743	6,587.3	4,189.3	63.6	47,843
Oct-Dec 97	2,491	2,264	227	105	38,465.5	27,791.0	72.2	6.48	5.89	13,383	6,247.0	3,820.5	61.2	48,852
Jan-Mar 98	2,429	2,272	156	71	38,260.1	27,038.2	70.7	6.35	5.94	12,704	6,052.7	3,513.4	58.0	49,776
Apr-Jun 98	2,476	2,356	120	49	38,332.7	29,533.7	77.0	6.46	6.15					51,332
Southwest														
Oct-Dec 96	832	784	48	28	16,802.4	11,431.7	68.0	4.95	4.67	12,795	2,148.9	1,188.4	55.3	23,395
Jan-Mar 97	887	800	87	51	16,926.0	10,513.6	62.1	5.24	4.73	12,046	2,163.7	1,097.2	50.7	23,980
Apr-Jun 97	957	800	156	94	17,672.1	11,288.4	63.9	5.42	4.53	12,722	2,264.0	1,180.6	52.1	24,226
Jul-Sep 97	997	845	152	93	18,494.3	12,176.9	65.8	5.39	4.57	13,019	2,362.1	1,274.1	53.9	24,273
Oct-Dec 97	975	847	128	81	18,501.4	11,654.2	63.0	5.27	4.58	12,612	2,361.5	1,222.6	51.8	24,454
Jan-Mar 98	943	831	112	70	18,137.1	11,102.3	61.2	5.20	4.58	11,849	2,304.2	1,161.6	50.4	24,573
Apr-Jun 98	1,079	870	209	133	18,849.6	13,236.7	70.2	5.72	4.62	13,766				24,850
TWA														
Oct-Dec 96	803	1,036	-232	-263	16,020.4	10,050.2	62.7	5.01	6.47	5,517	2,201.5	1,195.1	54.3	26,578
Jan-Mar 97	762	862	-99	-72	13,772.4	9,129.6	66.3	5.53	6.26	5,345	1,898.2	1,054.3	55.5	25,662
Apr-Jun 97	844	839	6	-14	14,705.8	10,273.7	69.9	5.74	5.71	5,958	2,051.9	1,169.5	57.0	23,490
Jul-Sep 97	908	845	64	6	15,922.4	11,447.0	71.9	5.70	5.31	6,324	2,209.2	1,284.2	58.1	22,539
Oct-Dec 97	813	812	1	-31	14,348.8	9,570.2	66.7	5.67	5.66	5,743	1,966.4	1,098.0	55.8	22,322
Jan-Mar 98	765	834	-69	-56	13,626.4	9,276.3	68.1	5.61	6.12	5,629	1,879.7	1,046.5	55.7	22,198
Apr-Jun 98	884	838	46	19	14,142.2	10,787.3	76.3	6.25	5.93					22,700
United														
Oct-Dec 96	3,976	3,923	53	19	65,894.4	45,617.2	69.2	6.03	5.95	19,948	9,505.3	5,615.2	59.1	86,008
Jan-Mar 97	4,121	3,927	194	105	64,832.6	45,296.6	69.9	6.36	6.06	19,683	9,386.1	5,530.0	58.9	86,443
Apr-Jun 97	4,382	3,970	412	242	67,458.0	48,894.2	72.5	6.50	5.89	21,271	9,917.6	6,032.1	60.8	88,939
Jul-Sep 97	4,640	4,077	563	579	71,375.4	53,721.0	75.3	6.50	5.71	22,641	10,566.8	6,561.1	62.1	90,324
Oct-Dec 97	4,235	4,144	91	23	68,364.7	47,419.6	69.4	6.19	6.06	20,608	10,269.1	6,023.6	58.7	91,721
Jan-Mar 98	4,055	3,932	123	61	66,393.3	44,613.0	67.2	6.11	5.92	19,136	9,987.5	5,589.7	56.0	92,581
Apr-Jun 98	4,442	3,972	470	282	69,101.7	50,152.2	72.6	6.43	5.75					94,100
US Airways														
Oct-Dec 96	2,052	2,003	49	27	23,684.1	16,146.1	68.2	8.66	8.46	14,412	3,182.8	1,755.7	55.2	43,144
Jan-Mar 97	2,101	1,925	176	153	23,397.6	16,009.3	68.4	8.98	8.23	13,773	3,141.2	1,734.3	55.2	42,225
Apr-Jun 97	2,213	1,957	256	206	24,014.0	17,707.1	73.7	9.22	8.15	15,533	3,234.0	1,911.0	59.1	42,320
Jul-Sep 97	2,115	2,032	83	187	24,070.3	17,668.5	73.4	8.19	7.83	15,080	3,245.5	1,918.0	59.1	42,159
Oct-Dec 97	2,085	2,015	70	479	22,662.2	15,800.1	69.7	9.20	8.89	14,178	3,066.2	1,733.2	56.5	40,865
Jan-Mar 98	2,063	1,871	192	98	22,102.1	15,257.8	69.0	9.33	8.47	13,308	2,993.8	1,669.2	55.8	40,974
Apr-Jun 98	2,297	1,923	374	194	22,818.3	17,567.1	77.0	10.07	8.43					40,250
ANA														
Oct-Dec 96	SIX MONTH FIGURES													
Jan-Mar 97	3,090	3,160	-69	-40	41,442.7	26,945.8	65.0	7.46	7.62	24,721				15,996
Apr-Jun 97	SIX MONTH FIGURES													
Jul-Sep 97	3,928	3,829	99	50	39,702.7	25,742.0	64.8	9.89	9.65	20,730				
Oct-Dec 97	SIX MONTH FIGURES													
Jan-Mar 98	3,459	3,545	-86	-68	40,446.9	26,187.7	64.7	8.55	8.76	20,102				
Apr-Jun 98	SIX MONTH FIGURES													
Cathay Pacific														
Oct-Dec 96	2,121	1,802	319	280	28,320.0	21,428.0	75.7	7.49	6.35	5,633	5,266.0	3,838.0	72.9	
Jan-Mar 97	SIX MONTH FIGURES													
Apr-Jun 97	2,037	1,856	179	138	28,172.0	20,044.0	71.2	7.23	6.60	5,208	5,074.0	3,613.0	71.2	
Jul-Sep 97	SIX MONTH FIGURES													
Oct-Dec 97	1,921	1,784	137	117	28,932.0	18,917.0	64.4	6.64						

Aviation Strategy

Micro-trends

	Group revenue	Group costs	Group operating profit	Group net profit	Total ASK	Total RPK	Load factor	Group rev. per total ASK	Group costs per total ASK	Total pax.	Total ATK	Total RTK	Load factor	Group employees				
	US\$m	US\$m	US\$m	US\$m	m	m	%	Cents	Cents	000s	m	m	%					
Korean Air																		
Oct-Dec 96	4,341	4,314	27	-249	54,071.5	38,136.6	70.5	8.03	7.98	23,741	10,953.3	8,253.2	75.3	17,439				
Jan-Mar 97																		
Apr-Jun 97																		
Jul-Sep 97																		
Oct-Dec 97	TWELVE MONTH FIGURES				3,029	2,774	255	-234	58,246.9	40,190.3	69.0	5.20	4.76	25,580	9,737.7	17,139		
Jan-Mar 98																		
Apr-Jun 98																		
Malaysian																		
Oct-Dec 96	TWELVE MONTH FIGURES				2,581	2,459	122	132	40,096.9	27,903.7	69.6	6.44	6.13	15,371	6,149.2	3,706.8	60.3	22,546
Jan-Mar 97																		
Apr-Jun 97																		
Jul-Sep 97																		
Oct-Dec 97	TWELVE MONTH FIGURES				2,208	2,289	-81	-81	42,294.0	28,698.0	67.9	5.22	5.41	15,117	6,411.0			
Jan-Mar 98																		
Apr-Jun 98																		
Singapore																		
Oct-Dec 96	SIX MONTH FIGURES				2,492	2,205	288	316	37,354.4	27,490.1	73.6	6.67	5.90	6,092	6,901.3	4,879.1	70.7	27,223
Jan-Mar 97																		
Apr-Jun 97	SIX MONTH FIGURES				2,549	2,171	379	402	38,125.4	28,216.7	74.0	6.69	5.69	6,135	7,231.0	5,091.5	70.4	27,777
Jul-Sep 97																		
Oct-Dec 97	SIX MONTH FIGURES				2,336	2,080	256	258	39,093.6	26,224.3	67.1	5.98	5.32	5,822	7,303.0	4,951.5	67.8	
Jan-Mar 98																		
Apr-Jun 98																		
Thai Airways																		
Oct-Dec 96	821	765	56	59	11,170.0	7,849.0	70.3	7.35	6.84	4,000	1,593.0							
Jan-Mar 97	824	777	47	25	11,369.0	8,128.0	71.5	7.25	6.83	4,000	1,621.0							
Apr-Jun 97	773	775	-2	11	11,352.0	7,583.0	66.8	6.81	6.83	3,700	1,620.0							
Jul-Sep 97	697	672	25	-1,050	11,462.0	7,668.0	66.9	6.08	5.86	3,500	1,639.0							
Oct-Dec 97	656	649	7	-661	12,144.0	7,715.0	63.5	5.40	5.34	3,800	1,712.0							
Jan-Mar 98	631	558	73	610	12,211.0	8,522.0	69.8	5.17	4.57	4,000	1,715.0							
Apr-Jun 98	586	583	3	-179	12,084.0	7,963.0	65.9	4.84	4.82		1,700.0							
Air France																		
Oct-Dec 96	TWELVE MONTH FIGURES				8,780	8,563	217	75	77,333.0	58,586.0	75.8	11.35	11.07	16,733	5,036.0		36,173	
Jan-Mar 97																		
Apr-Jun 97	SIX MONTH FIGURES				5,224	4,850	374	297										
Jul-Sep 97																		
Oct-Dec 97	SIX MONTH FIGURES				5,126	5,079	47	18										
Jan-Mar 98																		
Apr-Jun 98					2,303			23,051.0	17,247.0									
Alitalia																		
Oct-Dec 96	5,283	5,238	45	789	50,960.4	34,131.5	68.9	10.37	10.28	23,138	8,167.7	5,674.0	69.5	16,507				
Jan-Mar 97																		
Apr-Jun 97																		
Jul-Sep 97																		
Oct-Dec 97	TWELVE MONTH FIGURES				5,083	4,878	205	161										
Jan-Mar 98														18,676				
Apr-Jun 98																		
BA																		
Oct-Dec 96	3,301	3,087	215	154	35,976.0	25,417.0	70.6	9.18	8.58	9,075	5,056.0	3,494.0	69.1	58,911				
Jan-Mar 97	3,179	3,130	49	113	36,211.0	25,416.0	70.2	8.78	8.64	9,070	5,057.0	3,456.0	68.3	60,188				
Apr-Jun 97	3,624	3,395	229	260	39,697.0	28,756.0	72.4	9.13	8.55	10,613	5,589.0	3,875.0	69.3	60,083				
Jul-Sep 97	3,646	3,319	327	244	40,909.0	30,884.0	75.5	8.91	8.11	11,194	5,711.0	4,098.0	71.8	61,321				
Oct-Dec 97	3,580	3,436	144	110	40,059.0	26,929.0	67.2	8.94	8.58	9,837	5,618.0	3,791.0	67.5	61,144				
Jan-Mar 98	3,335	3,210	125	119	39,256.0	26,476.0	67.4	8.50	8.18	9,311	5,485.0	3,642.0	66.4	60,770				
Apr-Jun 98	3,783	3,497	286	217	44,030.0	31,135.0	70.7	8.59	7.94	11,409	6,174.0	4,157.0	67.3	62,938				
Iberia																		
Oct-Dec 96	4,384	4,120	264	30	36,975.9	25,931.2	70.1	11.86	11.14	14,623	5,252.3	3,216.3	61.2	26,280				
Jan-Mar 97																		
Apr-Jun 97																		
Jul-Sep 97																		
Oct-Dec 97	TWELVE MONTH FIGURES				4,168	3,900	268	126*	37,797.6	27,679.2	73.2	11.03	10.32	15,432				
Jan-Mar 98																		
Apr-Jun 98																		
KLM																		
Oct-Dec 96	1,483	1,494	-11	-4	16,806.0	12,346.0	73.5	8.82	8.89		3,010.0	2,203.0	73.2	31,866				
Jan-Mar 97	1,361	1,444	-83	-153	16,279.0	12,455.0	76.5	8.36	8.87		2,838.0	2,090.0	73.6	31,912				
Apr-Jun 97	1,692	1,566	126	99	17,310.0	13,640.0	78.8	9.77	9.05		2,996.0	2,335.0	77.9	34,804				
Jul-Sep 97	1,842	1,592	250	438	18,798.0	15,747.0	83.8	9.80	8.47		3,233.0	2,589.0	80.1	34,928				
Oct-Dec 97	1,630	1,570	60	23	18,096.0	13,555.0	74.9	9.01	8.68		3,098.0	2,404.0	77.6	35,092				
Jan-Mar 98	1,538	1,568	-30	528	17,598.0	13,240.0	75.2	8.74	8.91		2,981.0	2,250.0	75.5	34,953				
Apr-Jun 98	1,702	1,572	130	105	18,600.0	14,290.0	76.8	9.15	8.45		3,177.0	2,365.0	74.4	35,666				
Lufthansa***																		
Oct-Dec 96	4,369	4,195	174	165*	28,991.0	20,320.0	70.1	15.07	14.47	7,886	5,230.0	3,762.0	71.9	57,999				
Jan-Mar 97	3,198	3,198	-1	12*	28,099.0	19,726.0	70.2	11.38	11.38	9,186	4,985.0	3,477.0	69.7	57,291				
Apr-Jun 97	3,654	3,463	192	220*	32,109.0	23,465.0	73.1	11.38	10.79	11,618	5,505.0	3,893.0	70.7	57,901				
Jul-Sep 97	3,721	3,418	303	321*	33,739.0	26,410.0	78.3	11.03	10.13	12,807	5,787.0	4,298.0	74.3	58,178				
Oct-Dec 97	3,989	3,566	423	384*	30,209.0	21,691.0	71.8	13.20	11.80	10,839	5,457.0	3,919.0	71.8	59,630				
Jan-Mar 98	2,902	2,860	42	223	23,763.0	16,239.0	68.3	12.21	12.04	8,808	4,621.0	3,171.0	68.6	54,849				
Apr-Jun 98	3,507	3,081	426	289	26,132.0	19,489.0	74.6	13.42	11.79	10,631	5,048.0	3,575.0	70.8	54,556				
SAS																		
Oct-Dec 96	1,368	1,231	137	54*	7,678.0	4,688.0	61.1	17.82	16.03	4,948				25,530				
Jan-Mar 97	1,133	1,108	24	-36*	7,443.0	4,335.0	58.2	15.22	14.89	4,515				23,440				
Apr-Jun 97	1,379	1,151	228	178*	7,962.0	5,392.0	67.7	17.31	14.46	5,617				23,904				
Jul-Sep 97	1,244	1,093	151	83*	8,084.0	5,598.0	69.2	15.39	13.52	5,227				24,168				
Oct-Dec 97	1,334	1,204	130	63*	7,771.0	4,939.0	63.6	17.17	15.49	5,212				28,716				
Jan-Mar 98	1,184	1,077	106	76*	7,761.0	4,628.0	59.6	15.25	13.88	4,863				24,722				
Apr-Jun 98	1,323	1,149	174	107*	7,546.0	5,260.0	69.7	17.53	15.23	5,449				25,174				
Swissair**																		
Oct-Dec 96	1,285	1,348	-63	-355	16,372.6	11,074.0	64.4	7.85	8.23	4,857				10,202				
Jan-Mar 97	SIX MONTH FIGURES				1,787	1,724	63	76	17,464.4	11,880.7	68.0	10.23	9.87	7,643	3,340.6	2,291.9	68.6	10,163
Apr-Jun 97																		
Jul-Sep 97	SIX MONTH FIGURES				2,084	1,946	138	147	18,934.8	13,770.8	72.7	11.01	10.28	6,352	3,536.4	2,538.1	71.8	10,132
Oct-Dec 97																		
Jan-Mar 98	SIX MONTH FIGURES				1,907	1,780	127	86	18,983.8	13,138.7	70.5	10.05	9.38					9,756
Apr-Jun 98																		

Note: Figures may not add up due to rounding. 1 ASM = 1.6093 ASK. *Pre-tax. **SAirLines' figures apart from net profit, which is SAirGroup. ***Ex

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