

PAUL CLARK



Stormy Skies

Airlines in Crisis

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ASHGATE

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STORMY SKIES

For Judith, who has stuck with me through thick and thin

Note on Chapter Titles

The chapter titles are derived from song titles recorded by The Beatles.

‘I Should Have Known Better’

From the album *A Hard Day’s Night*, Parlophone, released 10 July 1964.

‘Tomorrow Never Knows’

From the album *Revolver*, Parlophone, released 5 August 1966.

‘Love Me Do’

Single, Parlophone, released 5 October 1962.

‘I Want To Hold Your Hand’

Single, Parlophone, released 29 November 1963.

‘You Never Give Me Your Money’

From the album *Abbey Road*, Apple, released 26 September 1969.

‘With A Little Help from My Friends’

From the album *Sergeant Pepper’s Lonely Hearts Club Band*, Parlophone, released 1 June 1967.

‘Strawberry Fields Forever’

Single, Parlophone, released 17 February 1967.

‘Here Comes the Sun’

From the album *Abbey Road*, Apple, released 26 September 1969.

All songs were written by John Lennon and Paul McCartney, except ‘Here Comes the Sun’, which was written by George Harrison.

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Preface

I am old enough to remember every major airline economic crisis since the jet age. This is not a boast, nor is it something that I particularly wish to celebrate, as my confession is merely a disturbing reminder of the ever-quickenning passage of time. But I have witnessed history repeating itself time and time again. The temptation to write about the most recent airline crisis, which can be traced back to the autumn of 2008 and has lasted well into 2010, was thus very strong.

In describing this book, I need first to say what it is not. *Stormy Skies* is not a compendium of startling new business models or processes offering an antidote to the ills of the crisis. Neither is it a blow-by-blow account of the downfall of the many airlines that have collapsed. That would be too depressing and serve no useful purpose. Rather, the book aims, through a series of essays, to shine a light on key commercial challenges that the airline industry is confronting. I offer no guarantees that airline executives who decide to apply any of my ideas, or those of my contributors, will emerge from the next downturn unscathed. However, I do believe that the subjects addressed in *Stormy Skies* are highly relevant to today's airline business environment and should not be overlooked.

As I have no affiliation with any airline, aircraft manufacturer, airport, supplier, user group or industry regulator, I have felt free to express my views in an objective way. This is refreshing for me, but I know that I am not going to please everybody. Indeed, I set out to be a little provocative at times and make no apology for so doing.

Stormy Skies starts with a look at past crises so that we can understand the repetitive cyclic behaviour of the industry, the dramatic effect of failure and the desperate need to improve our forecasting abilities. Economic downturns are rather like wars; there is a tendency to believe that there will never be another one. Then, a series of essays covers issues for which airline

management needs either a position or a strategy. These are: the risks of overcapacity in the face of unbridled enthusiasm from the original equipment manufacturers; the need to adapt to a world where passenger expectations have radically changed; the dangers, or otherwise, of massive industry consolidation; the perils of airline pricing; the potential of social media; and, naturally, the impact of environmental responsibility on the industry. Finally, some key industry figures gaze into my crystal ball and suggest some challenges we might face ten years hence.

One of my inspirations to address these subjects came from the late Sir Adam Thomson, founder of British Caledonian Airways, who said, 'A recession is when you have to tighten your belt. Depression is when you have no belt to tighten. When you've lost your trousers, you're in the airline business.'

Paul Clark

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Chapter 1

‘I Should Have Known Better’: A History of Crisis and Prediction

Hindsight is a wonderful thing. Yet it is an immutable fact that business leaders, analysts, politicians, soothsayers and gurus throughout the developed world failed to anticipate the impact of the latest economic crisis. More and more countries slipped into recession at the end of 2008 and it seemed as though we were all taken by surprise. It is human nature to conveniently overlook our failings to see the obvious. However, if we take a good look at history we should be prepared to admit that this crisis, like many before, was as inevitable as night follows day. This chapter sets out to appraise the specific events that have regularly dragged the airline business into crisis. We shall see that although previous crises have been very different in nature, a definite pattern of rise and collapse is apparent.

The airline industry is particularly vulnerable to the swings and roundabouts of the global economic system. It walks a permanent tightrope of wafer-thin margins, costs that are increasingly beyond management's realistic control and a demand for its services that is hard to predict. If this were not enough, the cocktail of risk is peppered by the highly competitive nature of the airline business, which drives prices down and leads individual players into endless forays of product investment to keep a grip on market share. Even if we lay aside the spectre of the recession, the airline business is constantly vulnerable to a plethora of potential mini-shocks to the system. Political upheavals, terrorist activity, wars or outbreaks of disease can snap at the heels of airline profits at any time.

We owe it to a nineteenth-century Frenchman, Clément Juglar, who was among the first, if not the first, to correctly identify what we now know as the ‘business cycle’. Juglar was a physician as well as an economist and, having lived through the economically-motivated public disturbances of 1848, became interested in how the state of trade influenced the behaviour of the population. By using time-series data he was able to predict the turning points in economic activity (*Encyclopaedia Britannica* 2009). Juglar was the first to observe, for example, that the state of people’s bank balances was an indicator of the magnitude of commerce. Sounds familiar? Although Juglar is largely forgotten today, he is revered by economic theorists as being the first to have recorded that the ebb and flow of business activity is indeed a regular phenomenon, and one based on a cycle of roughly 8–11 years. His ground-breaking book, *A Brief History of Panics and Their Periodical Occurrence in the United States*, was first published in 1893 and is still in print today (Juglar 2005). We shall see that the airline industry appears to have fallen neatly in step with the so-called Juglar cycle.

Among the many economists who developed business-cycle theories after Juglar, another stands out. An early twentieth-century Russian economist called Nikolai Kondratiev hit upon the idea that capitalist economies are subject to so-called supercycles that last for an average of 50 years. His theory was actually one of a number that attempt to explain long-term macro-patterns. Such elongated cycles tend to be driven by a variety of major factors such as wars, exceptional crises in the capitalist system or ground-breaking innovations. Kondratiev’s ideas were taken up by the leading and prolific Austrian economist Joseph Schumpeter, who devoted seven years of his life at Harvard to produce a 1,000-page monster analysis called, simply, *Business Cycles*, in 1939.

Schumpeter was, by all accounts, a colourful character. He reputedly fought a duel with a librarian over access rights to books for his students and would arrive at faculty meetings dressed in jodphurs and various horseriding paraphernalia. Schumpeter claimed that his ambitions were to be the world’s greatest economist, greatest horseman and greatest lover (Perelman 2008). However, of these three ambitions, it was the effort to produce his opus on business cycles that mostly drove him to

exhaustion. He wrote to a friend, "I worried last night till two am on such questions as whether potatoes were important enough in Germany in 1790 to count in the business cycle"" (McCraw 2007). One can easily imagine the exhausted Schumpeter labouring and fretting over his monster tome. Certainly, to his chagrin, the book was never to become a commercial success, but it came to be regarded as a watershed in the history of academic research into economics.

It was Schumpeter who named the elongated cycles 'Kondratiev waves', after the man who identified them. The waves have since re-emerged as the grandly-named Schumpeter–Freeman–Perez paradigm (Freeman and Perez 1988). Essentially, five key waves of high prosperity stand out over the last 200 years (see Figure 1.1). These are: the peak of the Industrial Revolution, the railway boom of the mid-nineteenth century; the emergence of electrical power and predominance of heavy engineering; the impact of motor vehicles, together with the oil economy and mass production; and, finally, the information technology revolution. You may notice a startling omission from this list. The air transport revolution, which so radically altered everyone's lives in the last century, is apparently not deemed significant enough

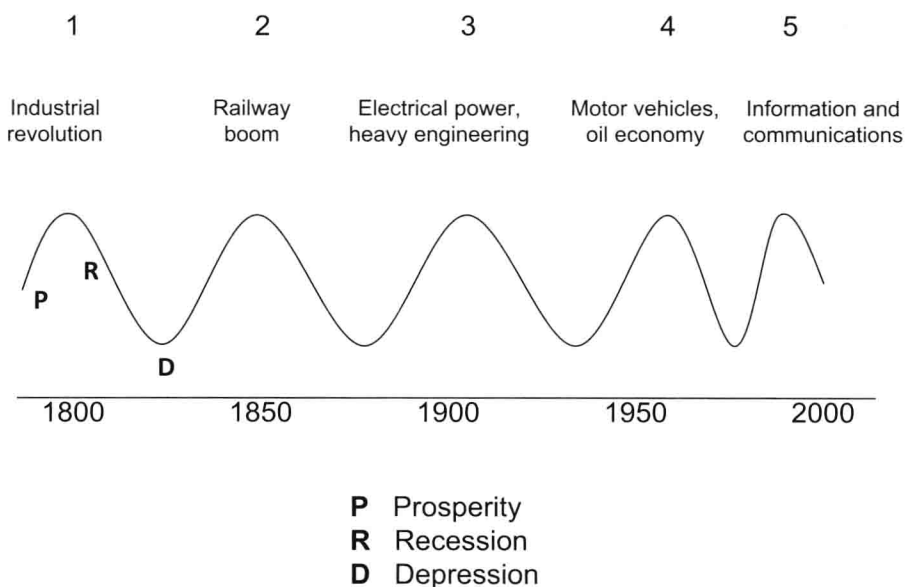


Figure 1.1 Kondratiev waves