

A MAGAZINE FOR AIRLINE EXECUTIVES

2011 Issue No. 1

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BETTING THE COMPANY

Aircraft manufacturers bet their success on two flagship products

During the halcyon days prior to the global financial crisis, both Airbus and Boeing made massive investments in the development of their new flagship products.

■ By Kay Denton | *Ascend* Contributor



High profile, widely anticipated launches of new aircraft attract attention. Every flaw and delay is subject to media commentary and scrutiny. This begs a key question, “Are the start-up costs and risks of developing new-generation aircraft so great that a manufacturer has to bet the company on the success of its delivery?”

In the days of high passenger-demand growth — 2005 through 2007 — airlines around the world ordered more than 6,500 aircraft. That included more than 200 Airbus A380s and more than 750 Boeing 787s, even though these two aircraft had never flown a single commercial flight.

Then, however, the global financial crisis prompted airlines to rethink capacity decisions. Manufacturing defects coupled with production delays gave these airlines the excuse to blame Airbus and Boeing for their continued financial woes.

Both manufacturers have paid massive penalties on the two most innovative and majestic aircraft to be conceived in recent history. The A380 and B787 aircraft have experienced serious delays. From this, Airbus was the first to pay large penalties for manufacturing defects and its failure to deliver.

The A380 entered into service with Singapore Airlines in October 2007 after a delay of more than two years due to production issues. Since then, it has been delivered to various customers including Air France, Emirates, Lufthansa and Qantas Airways, often to operate high-profile routes.

In the case of Emirates, it has proven hugely popular with customers, resulting in consistently high load factors. Customers seem keen to fly on an aircraft that offers spacious seats and aisles as well as a smooth journey.

Air France similarly flies the A380 on prestigious routes to New York, Tokyo and Johannesburg. The carrier will serve Beijing, Mexico City and Washington Dulles, following upcoming deliveries of the super jet.

The downside to using the A380 for high-profile services occurs when there is an aircraft out of service without an A380 spare as demand exceeds the capacity of replacement aircraft. The A380 capacity is almost double that of another aircraft.

In November, following an uncontained engine failure, Qantas Airways’ A380 fleet was grounded. Its entire network was fraught with chaos while trying to provide sufficient capacity in lieu of the super jet. It took a lot of time to reaccommodate displaced passengers.

Qantas only started reemploying its A380 on the Los Angeles route on Jan. 16, while the London route recommenced in November. The airline received a substantial



Airbus Delivers Despite lengthy delays, the Airbus A380 has been delivered to launch customer Singapore Airlines along with several other carriers around the world.

amount of criticism for passenger displacement during the holiday season.

Airbus invested between US\$15 billion and US\$20 billion since 1991 to develop the A380. The manufacturer’s aim when developing this model was initially to build an ultra-high-capacity airliner and challenge Boeing’s dominance of the market. One could argue that it has achieved both of these objectives in providing the largest capacity carrier ever as well as increasing its market share and decreasing that of Boeing’s.

In 2009, Airbus achieved 54 percent of market share in aircraft that have more than 100 seats. Nonetheless, its new-found leadership in this sector has come with substantial cost. The A380 is a high-profile, desirable flagship for the Airbus fleet. However, the complexity of manufacturing has led to delays that have cost the Toulouse, France-based company an untold but very large amount of profits paid out to airlines in penalties for late delivery.

In January, Airbus announced the biggest sale in aviation history when Indian airline IndiGo placed an order for 180 planes (30 A320 “classics” and 150 A320-neos). Such an order early in the year gives a huge boost to the company; however, none of these orders are for the A380.

“It’s definitely an attractive flagship for airlines, but it will never be the mainstay of anyone’s fleet,” said Richard Abouafia, vice president of U.S.-based Teal Group.

This prompts the question, “Should Airbus have spent less money investing in the A380 and more funds in aircraft such as the A320-neo?” It has the ability to be a best

seller and a workhorse aircraft for airlines across the globe.

Launch customer ANA planned to unveil the Boeing 787 in September 2009. However, delivery delays caused a setback until the third quarter 2010. But before delivery could occur, there was a fire onboard a test flight in November 2010, which has pushed back delivery to the third quarter.

ANA has ordered 55 B787s for operation on both long-haul and domestic flights. The airline plans to start operating the first B787 within one week of receipt.

“The move into commercial service takes a very short time,” said ANA President and Chief Executive Officer Shinichiro Ito. “It could just be one week from the delivery.”

Because of long delivery delays, ANA seeks compensation from Boeing despite acknowledging that this is a regular occurrence in the industry between the airline and the manufacturer. Ito believes that once the aircraft arrives it will be worth it, provided Boeing delivers what it has promised.

Other carriers with orders for the B787 include Ethiopian Airlines, JAL, Kenya Airways, Korean Air and Qatar Airways. The aircraft has more pre-production orders than any new aircraft. The aircraft model should help transform, develop and grow the airlines’ international operations.

Ethiopian was set to be the launch customer for the B787 for Africa. Despite two years of delays, the carrier also believes the outcome will be worth the wait. However, the carrier has voiced concerns about the handling of the delays.

“Unfortunately, Boeing is not run by commercial people,” said Akbar Al Bakar, CEO

of Qatar Airways. “Boeing is run by bean counters and lawyers. We have some serious issues with them, and if they do not play ball with us, they will be in for a serious surprise.”

Despite these concerns, as late as last December, Al Bakar maintained his confidence in Boeing in spite of his disappointment by the delays. As it looks like Boeing may now delay the delivery of the first B787 for production use until the third quarter there will undoubtedly be substantial penalties owed to its customers.

Penalties certainly impact manufacturers’ bottom lines; however, airlines are not able to easily cancel orders. They typically must pay about 40 percent of the list price of an aircraft in pre-delivery payments. These payments are paid well in advance of the aircraft being delivered and are forfeited by the airline if the order is cancelled.

Additionally, the payments acquire inflation costs. So, as the economy recovers, even airlines that have made orders are already seeing the cost of their aircraft increase in pace with inflation. The increases in aircraft costs will undoubtedly offset some of the penalties.

Because there are only two main suppliers of wide-body aircraft in the industry, it is not a buyer’s market with unlimited choice. So airlines experiencing delays can only go to the other competitor to secure a better deal. In doing so, they might experience a similar delay for a flagship product.

While Airbus and Boeing are the only viable options for wide-body aircraft, there will be fewer risks associated with these delays and manufacturing defects for suppliers.

Regardless of these penalties and the potential loss of reputation, it appears that the introduction of these two innovative aircraft were good decisions by the manufacturers despite the massive risks.

First, airlines and passengers have short memories. Delivery difficulties were soon forgotten when the A380 was finally delivered. History will undoubtedly repeat itself once the B787 goes into operation.

Second, critics aren’t always right. They thought the Boeing 747 would be short lived. They believed production would cease after 400 aircraft. Despite skepticism, it exceeded the production of 1,000 aircraft in 1993. Today, it remains a popular aircraft.

The Boeing 737, with production in excess of 6,600 aircraft and more than 2,000 still to be delivered, is regarded the most successful commercial airplane. These different examples show that flagship products such as the A380 and the B787 have a good chance for success even if there are difficulties early in their introduction.

The philosophies of the two major wide-body aircraft manufacturers differ



ANA Compensation Dreamliner launch customer ANA seeks compensation after extended delivery delays.

significantly with reference to their flagship developments.

Airbus sought to focus on specific high-density routes where airport space and slots are constrained. It wanted a large aircraft that could provide unprecedented lift and low costs per seat to service these dense markets.

Boeing’s outlook with the conceptualization of its B787 Dreamliner was to construct an aircraft of medium size but very long range with outstanding operating cost characteristics. (The aircraft is predominantly carbon fiber, making it much lighter.) This would support point-to-point operations between cities that are not super-high demand.

Airbus maintains that its approach serves the most markets, allowing connectivity over major hubs. Boeing can point to a more tailored customer experience, resulting from an excellent travel experience between cities where the true demand is growing. Both companies are right. There is room in the marketplace for both of these aircraft for exactly the reasons intended by the manufacturers.

Furthermore, these aircraft both have outstanding “green” credentials at a time when environmentally friendly transport is garnering a great deal of public attention.

The A380 is green because it carries up to 800 passengers on a single flight. It is less damaging to the environment because fewer flights are necessary to carry the same amount of traffic.

Meanwhile, the all-carbon-fiber construction of the B787 makes the aircraft lighter so it uses about 20 percent less fuel for flying

the same number of passengers over the same distance as a conventional aircraft.

The future looks promising for both the A380 and the B787. Orders are on the increase as air traffic demand continues to rise. The A380 has 40 aircraft in operation with a further 234 on order, and the B787 has 847 orders to fulfill during the next decade.

Given the unprecedented attention both aircraft have garnered and the substantial impact they will have on the industry, it is fair to say that the manufacturers can focus on more standard aircraft for the coming years because they have delivered their showpieces.

Airbus and Boeing have had to bet their success on these two flagship products. However, it appears the investment is well worth the risk. Both aircraft types have sparked huge interest in the airline industry and advanced aviation into a new century of innovation. **F**

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