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JET STREAM

A conversation with Wolfgang Prock-Schauer, the chief executive officer of Jet Airways.



Special Section

FUELING UP

A look at the rising cost of fuel and its effect on the industry.



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The Cost of Fuel

Airlines are taking a number of steps to cope with the high price of jet fuel.

■ By Vijay Bathija | *Ascend* Contributor

Fuel price has been on the minds of virtually every airline executive for the past several months. Despite a slight dip at the end of 2006, fuel prices have remained at relatively high levels, remaining above previous highs. Only a year ago, crude oil touched a new record of US\$75.35 per barrel and jet fuel reached nearly US\$100 a barrel.

Oil prices have been a major drain on budgets of all airlines. After years of decline, evidence indicates that revenue yields are finally improving. U.S. domestic carriers have seen almost a 12 percent increase in yield year over year. However, fuel has continued to keep the margins tight and negative in many cases.

Since 2001, airlines have made significant efforts to reduce costs through various means such as:

- Reduction of the number of fleet types,
- More efficient use of the existing fleet,
- Labor concessions,
- More efficient use of personnel through automation.

All these efforts have resulted in reducing controllable costs for U.S. carriers. However, fuel prices are becoming an ever-increasing component of total costs. For U.S. domestic carriers, fuel prices have gone from being only 13 percent of the cost in 2000 to almost 24 percent of total cost currently. For many carriers in the Middle East, the fuel cost is between 25 percent and 30 percent of total costs. Very few carriers can afford to hedge all their fuel requirements. And now, fuel has been high for so long that even those that did hedge are running out of affordable options. As a result, even though there has been a significant effort to reduce costs other than fuel, higher fuel costs have resulted in higher total costs.

Fuel prices are mostly an uncontrollable cost for airline management. Jet fuel prices depend on the price of crude oil and on “crack spread” — the difference in the cost to refine gasoline versus jet fuel. As crude oil prices

increased, the crack spread also widened. The final price also includes a service charge from fuel providers. Collective negotiations by alliances with common fuel providers can offer some leverage to airlines to obtain a good deal and reduce fuel overhead.

Airlines are working with this new reality in their planning and operations. While fuel price itself is uncontrollable by any single airline, airlines can take measure to alleviate the impact of fuel price, including:

- Saving on the consumption of fuel — Consumption of fuel can be controlled to some extent. Through optimized flight planning, tankering and other methods, fuel consumption can be decreased. The savings depend on the maturity of airlines and their current fuel consumption practices. Airlines have been able to achieve 2 percent to 3 percent savings on fuel consumption through the above techniques. Consultants from the *Sabre Airline Solutions*[®] consulting practice have also worked with airlines during the past year to achieve savings. The good news is that all savings on fuel consumption go directly to an airline’s bottom line.
- Accounting for higher fuel price in capacity decisions — Higher fuel price means a higher breakeven point for airlines to make money on marginal flights. While most of the planning is done on historical data, significantly higher fuel prices, which have tended to stay high, should be taken into account while planning for additional flights. There is evidence that such actions have had impact on capacity decisions. As the breakeven point has increased, airlines did not add significant capacity in 2006. The U.S. domestic market has seen a 2 percent decline in capacity year over year in the second quarter of 2006 versus the same period the previous year.
- Optimizing fleet deployment and fleet planning — Many network carriers have a mix of aircraft. When fuel becomes a higher component of total cost, more fuel-efficient aircraft

should be flown more often. If two aircraft are available and suitable for a mission, everything else being equal, more fuel-efficient aircraft should be deployed. Planning tools such as the *Sabre[®] AirFlite[™] Fleet Manager* can help optimize the deployment of aircraft in a given fleet to minimize costs. In the longer term, such tools also help in optimum fleet planning. Fuel price is accounted for as variable cost in *Fleet Manager* and sensitivity regarding fuel price can be taken into account to evaluate the impact of fuel cost on various fleet options. As fleet is an expensive and long-term decision, such decision-making tools help airlines make the right decisions.

- Implementing fuel surcharges to recover higher fuel price — On the revenue side, fuel surcharges have been imposed by many airlines to recover the higher cost of fuel. Fuel surcharges provide cushion against fuel prices increase in the form of revenue. Airlines have successfully imposed fuel surcharges even in a competitive market environment simply because it has almost become a necessity to survive. In mid 2006, average fares showed increases of 10 percent to 12 percent. Fares for flights from the United States to Europe increased 12 percent for the summer months. And fares for flights from the United States to Asia were also higher by 8 percent to 10 percent.

Everyone in the industry is concerned about higher fuel price. However, while acknowledging that fuel prices increase and decrease in long cycles, airlines can make operational and commercial decisions to minimize the impact of high fuel costs. ■

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