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IN THE BLACK

A conversation with …

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Unblocked

Airlines in Central and Eastern Europe face several challenges such as the expansion of low-cost carriers and currency corrosion that have many of them rethinking their business strategies.

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Ascend Contributor

IN Central and Eastern Europe, the times when national carriers had full monopoly are long gone. With the liberalization of the industry and the development of low-cost carriers, traditional mainstream flag airlines have had to face a harsh reality.

The changed rules of the game, however, bite much harder for some of the Central and Eastern European small to medium carriers, such as CSA Czech Airlines, LOT Polish Airlines and Malév Hungarian Airlines, with low-cost competition on the rise.

For several years, airlines in the region faced fierce competition from western low-cost carriers. The first so-called "cheap" airline operator appeared in the Czech market in 1999, followed by GoFly (now easyJet) connecting Prague, Czech Republic, to London, England. The market share for LCCs across the entire region is about 25 percent, with 10 of the region's prominent low-cost airlines flying to Prague.

Most of the national airlines operating in the region were, and still are, government owned. Their decision-making processes and speed of responding to ever-changing market conditions is somewhat slower than in aggressive market organizations.

Although the population of the new European Union member states is relatively large (75 million), the percentage of airline travelers is still relatively low. The combined number of international scheduled passengers per capita among the new member states is only 0.3 percent versus 1.3 percent for the 15 original European Union countries. Despite the attempt of the region's national carriers to attract non-domestic passengers, they still carry very high proportions of their own citizens.

> "Passengers faced with a decision between paying slightly higher prices or flying with an 'unknown carrier from behind the iron curtain' would naturally lean toward the more well-known international airlines."

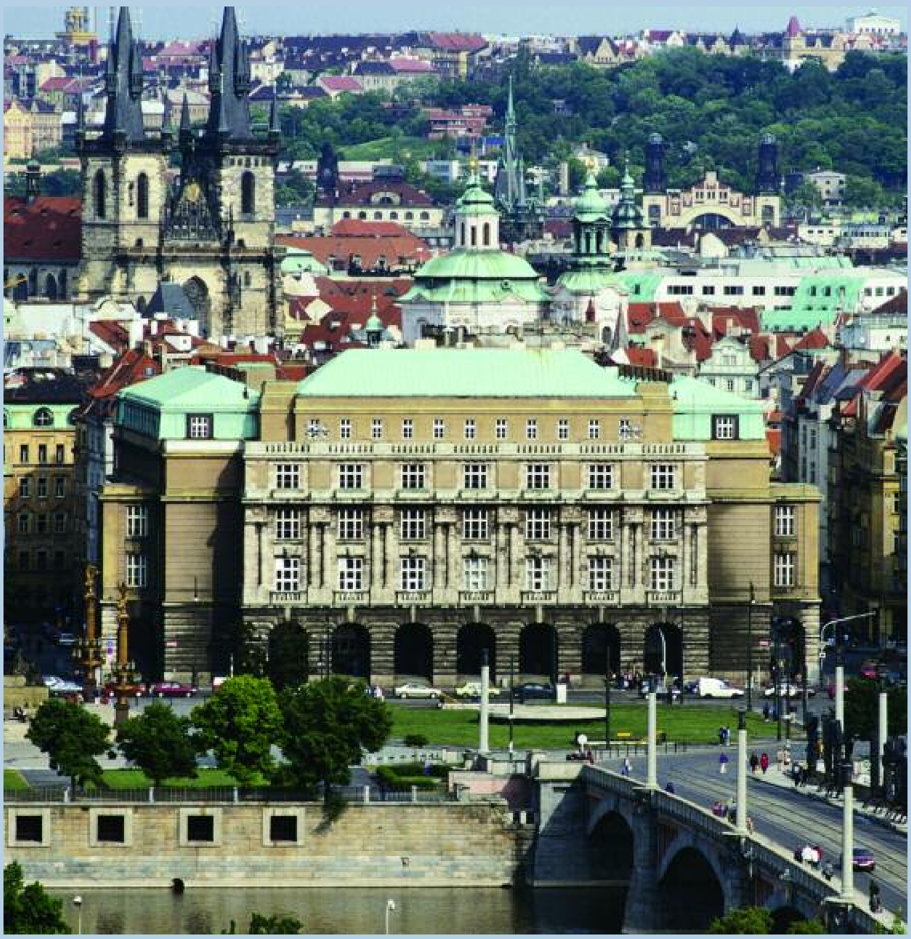
Another discriminating factor is their image of being associated with old, outdated, legacy aircraft; bad service; and poor safety records. The reality, however, is very different; these airlines, like their competitors, have modern aircraft, enhanced service levels and high safety standards. Despite their long presence in the airline market — CSA with 82 years, LOT with 75 years and Malév with 50 years — most carriers in the region are virtually unknown to the international traveler outside the region. Passengers faced with a decision between paying slightly higher prices or flying with an "unknown carrier from behind the iron curtain" would naturally lean toward the more well-known international airlines. Furthermore, the budgets for international marketing are certainly limited and the region's airlines, in turn, rely heavily on their own citizens or the nostalgia of old-time immigrants.

The major challenge for these airlines is labor, rather ironic given that the cost of labor in the region is well below the average for the 15 established members of the European Union. Most airlines in the region have both numerous and strong unions — CSA leads the pack with 10 unions, followed by LOT with seven. The fact that different unions pull different ways adds to the challenges of the region's airlines. All this creates a highly disruptive environment where, year after year, high-level management has to spend huge amounts of time on negotiations, trying to resolve internal disputes and reduce unjustified old-era benefits. It is also the case for nearly all airlines that the number of staff is far too high in comparison to their leaner and meaner counterparts.

A new and unique challenge for this region is currency corrosion. In the past, most of the local currencies gradually depreciated. These days, the markets work in the opposite direction. With the improving economy of the region, LOT has reported that a large chunk of its revenue last year was wiped out due to the currency movements in favor of the Polish zloty. The dollar depreciated by 21 percent and the euro by 14 percent against the local Polish currency. Most airline transactions are handled in non-domestic currencies, yet the results are expressed in the zloty. Moving exchange rates can also put unpredictable strain on the system.

Despite the major differences in the LCC model, including completely different cost structures, airlines in Central and Eastern Europe seem to fall into a dangerous pattern of trying to compete against the low-cost competition. This is not only done through drastic reductions on their price structure, but also by sometimes lowering their standards onboard. Flag carriers always served a particular niche of the market, specifically business customers, but if there is virtually no difference between national carriers and their LCC counterparts, passengers would certainly choose the cheaper option.

In addition to the growing low-cost carrier competition, another challenge facing Central and Eastern Europe and its flag airlines is currency corrosion. In Poland, the currency movements in favor of the Polish zloty have seriously impacted LOT Polish Airlines' revenue.



A growing force in the airline industry, low-fare airlines assume about 25 percent of the market share in Central and Eastern Europe, with 10 of the region's eminent low-cost carriers flying to Prague, Czech Republic, home of flag carrier CSA Czech Airlines.

While many of these circumstances are specific to the region, there still exists an entire selection of other "universal" industry factors such as the price of fuel and terrorism threats that add a considerable amount of pressure to airlines.

A testimony to the fact that there is a lot of interest in the new E.U. member states is the number of LCCs operating in the region, with more than 70 low-fare airlines now operating across the European continent, most of which fly to Central and Eastern Europe.

The market is certainly versatile, ranging from well-known and established international LCCs such as easyJet and Ryanair to local Central and Eastern European operators such as Sky Europe and Wizzair to LOT's carrier-within-a-carrier, CentralWings.

With the exception of the genuine interest of overseas travelers in the region, there is another reason why so many carriers fly east — the great potential for market growth. As economies and income levels gradually improve to Western European standards, more and more Eastern Europeans take to flying. Both mainstream flag carriers and LCCs in the region have already noticed a significant increase in traffic and the number of passengers boarded. That trend is on the increase year after year, and it's likely to continue for some time.

It is inevitable that the competition for these markets will not just go away. On the contrary, it is likely to get even more aggressive, employing market tactics such as price undercutting to snatch a customer from the hands of the competition.

In terms of market saturation, few more casualties in the LCC market could be expected, with a possibility of a few new mergers.

While most, if not all, of the region's flag carriers will likely be around for years to come, attempts at bringing aspects of the LCC model into their own operations is counterproductive. Instead, they should focus on raising their standards and service levels to appeal to current and perspective customers who have higher expectations and don't necessarily determine their purchasing decisions purely on price.

For carriers in Central and Eastern Europe, there remain a number of areas that require improvement; however, their ability to adapt quickly to changing market conditions is vital and should become the focal point. As Charles Darwin said, "It is not the strongest that survives, nor the most intelligent, but the one most responsive to change." While advanced information technology supports this business need, for many carriers, there is great hesitance to make that initial investment, which, in many cases, is a lifesaver.

Commonly, airlines in the region continue to experiment and often make costly mistakes before turning to external resources. The bottom line, however, is that every aspect of an airline, whether it's aircraft, technology or staff, has to remain current to fend off competition and retain customers.

Probably the most obvious, but often forgotten, element to an airline's success is keeping customers happy. It is truly the passenger who is the basis of the airline's existence, and if they can't be retained, even the most strategic cost-cutting and revenue-generating initiatives won't be enough to sustain long-term success.

While many Central and Eastern Europe-based carriers have a lot of adjustments to make as a result of a changed aviation landscape, most of them will climb aboard and make changes necessary to give their competition a run for their money. a

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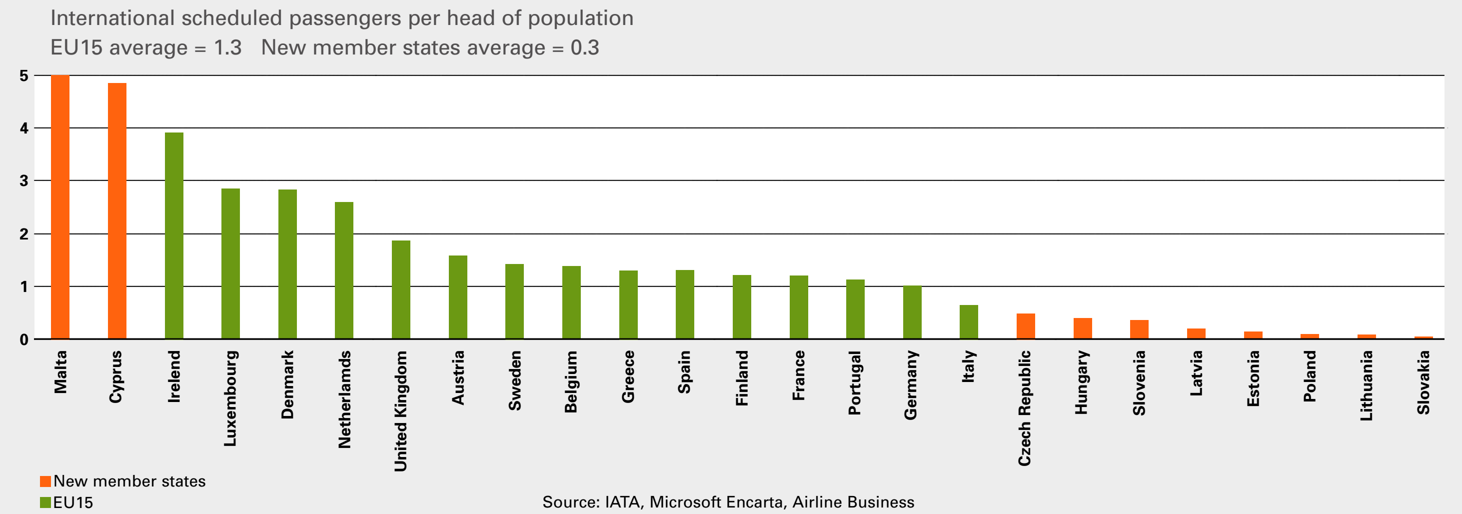
Propensity to Fly by EU Country
International scheduled passengers/population



Source: IATA, Microsoft Encarta, Airline Business

The European Union has recently expanded, adding 10 new members, which make up 0.3 percent of scheduled international passengers per capita, and the initial 15 E.U. members make up 1.3 percent. Although the population is high in Central and Eastern Europe, the local-community is less likely to fly for historical and economical reasons.