HOW MAJOR EUROPEAN AIRLINES NAVIGATE RELENTLESS PRESSURE
Navigating mounting pressures

The airline industry is notorious for its competitiveness and vulnerability to external shocks. European network carriers are facing—and in some cases, withstanding—intense pressures including currency fluctuations, political instability and terrorism in important leisure destinations, and a notable rise in fuel prices. Competitive invasions from low and ultra-low-cost carriers (LCC and ULCCs respectively) are adding to the pressure.

New entrants and new business models are encroaching on the legacy airlines’ traditional sources of revenue, gaining share in intra-European markets and also expanding into North Atlantic markets. Additionally, the “super connectors” concentrated in the Middle East have impact on traffic patterns between Europe and markets in Asia and Africa. The LCCs and ULCCs continue to gain strength as they invest in new fleets and upgrade to more competitive cabin product offerings.

In the face of this onslaught of challenges, major European airlines have not stood still. With varying degrees of success, IAG, Lufthansa and Air France/KLM (the “European Majors”) have strengthened their positions in home markets, increased the pace of securing partnerships and joint ventures, and launched cost-efficiency programs. However, with no sign of competitive pressures easing, the question facing European legacy airlines is two-fold: How to accelerate their competitive response to new entrants? And where to find their next set of operating and cost efficiencies?
Lagging margins hinder growth

In the past decade, the European Majors have faced difficulties in their core business and network, resulting in margins that have lagged the global airline industry (as measured by IATA), and lagged in improvement versus counterparts in North America and Asia — see Figure 1. This trend has been slowing as the European Majors have taken mitigative action and as large Middle East carriers moderate their aggressive expansion.

Figure 1. EBIT margin and EBIT margin improvement for European, Asian and North American airlines

Source: IATA Industry Economic Performance review, June 2018
International competition

One of the more significant sources of margin erosion has been the rise of the three large Middle East carriers. Emirates, Qatar and Etihad (collectively the ME Big Three) have strategically targeted traffic between Europe and Asia, which was once a source of profit for the largest European airlines. In the past 10 years, the ME Big Three have grown their widebody fleets by 10 percent per year, a rate that is five times faster than the European majors.¹ In parallel with the aggressive capacity growth, the ME Big Three have built sophisticated hub structures designed to divert major intercontinental traffic through the region.

Looking at a snapshot today, the ME Big Three carry more passengers than all Asian network carriers combined and far outpace the growth of European network carriers. In the past two years, the ME Big Three moderated their growth but remain faster than their European competitors. These competitive dynamics have had a dramatic impact on yields. As measured in US dollars, yields have fallen at a compounded rate of 6.2 percent per year since 2012.² With approximately 500 new widebodies on order by the ME Big Three, the European Majors can expect the competitive pressure to continue to intensify for many years into the future.

Figure 2. Airline passenger traffic and yields

East and Southeast Asia – Europe traffic
Passengers (trailing 12-month total), both directions, selected carriers

Source: IATA Direct Data Solutions
Intra-European competition

Competition from new entrants in the intra-European markets has a longer history. Since 2006, European LCCs and ULCCs have grown their fleets at a rate of 12 percent per year. During this same period, European Majors have also grown capacity, but at a lower 2 percent per annum rate. Consequently, the LCCs and ULCCs have increased their capacity share from 17 percent to nearly 40 percent, with further erosion of European network carriers’ market share likely in the coming years.

Similar to the ME Big Three, the European LCCs and ULCCs continue to have aggressive growth plans. On top of the approximate 1,200 in service aircraft, the European LCCs and ULCCs have another 925 aircraft on order. When adjusted for expected retirements, we project the LCCs and ULCCs to operate close to 1,800 aircraft by 2025, which could bring them to parity with the major European network airlines.

The sustained competition from European LCCs and ULCCs has impacted yields in intra-European markets as well. Compared to 2012, yields today are 20 percent below those levels.

Figure 3. Intra Europe LCC ASK share development and yield development

European LCCs and ULCCs are also looking to expand into the lucrative North Atlantic market. The past 24 months have seen rapid growth of early stage entrants such as Wow Air, Norwegian and WestJet (from North America). However, with less than 5 percent of the market today, it is too early to predict the ultimate impact these new entrants will have on the market. Current order books may bring this share close to 10 percent in the next five years.
Mitigating actions

Against the challenging backdrop described above, the European Majors have been on the move.

While the European market lags the degree of consolidation visible in the North American market, the top four carrier groups (IAG, Lufthansa Group, Air France KLM and Ryanair) now account for 43 percent of European capacity versus 39 percent in 2009. In comparison, North American consolidation has been faster and stronger with the top four carriers growing their share from 55 percent to 68 percent over the same time period.

Equally important, the European Majors have successfully defended, and in some cases, grown market share in their home markets. Each of the European Majors now enjoy greater than 50 percent share of the takeoff and landing slots at their home airports. The Lufthansa group remains best positioned on this measure with a 70 percent share in Frankfurt, while IAG has made the most progress moving its share up 13 points since 2011 at London Heathrow to a current position of 57 percent.

The European Majors have also been successful in developing a comprehensive set of joint ventures agreements with carriers across the globe. These joint ventures have proven successful in linking international hub and spoke systems and improving the network reach and product offering to core customers. Since 2011, European Majors’ joint ventures are becoming a dominate structure in inter-continental markets — see Figure 4.
Figure 4. European joint venture agreements

Source: Collection of 2018 public new joint venture data
Ramping up customer experiences

The larger competitive landscape in Europe is ultimately good for customers. Passengers will enjoy a number of benefits, including:

**Lower fares.**
Supply and demand influences fares more than input prices. With such abundant supply of capacity, fares are dramatically lower today (20 percent) than they were three years ago. Europe is leading the world in offering attractive, one-way fare structures for both short- and long-haul traffic.

**Greater choice and transparency.**
There are more ways for carriers to sell to customers. Fast-growing distribution channels (e.g. online aggregators) facilitate greater price transparency for customers. At the same time, carriers are attracting customers to their direct channels with innovative, tailored branded fares. Carriers are also expanding towards offering more packaged holiday products with airfare and hotels.

**More destinations.**
New markets and destinations are becoming available as LCCs and other operators expand their networks.

**Attractive perks.**
Carriers are evolving loyalty programs in an effort to meet customers’ high expectations. Through a variety of distribution channels, customers will enjoy benefits such as:
- Lounge access
- Accelerated check-in process
- Earlier access to seat assignments
View forward

The competitive threats outlined above will continue for the foreseeable future.

Yield pressures will remain across all of European aviation and combined with the recent rise in fuel prices, weaknesses within business models will begin to surface. To respond to continued competitive threats while delivering sustainable returns on capital, all European airlines will need to overcome a range of structural and organizational challenges.

The most fundamental long-term challenge is to continue to seek a more rational competitive structure while balancing their long-term supply against a competitively determined market demand. This will require proactive management of European government affairs, regulatory and anti-trust frameworks. Successful solutions will involve further consolidation through M&A activity and/or liquidations of competitors as well as deepening international partnerships through sophisticated joint venture frameworks.

Like other customer-facing industries, strong brands are paramount to long-term success. The only medium-term protection from competitive disruption is a continual enhancement of the customer proposition combined with concurrent improvements in efficiency of how it is delivered. A key element of this better and more efficient approach will be how quickly European carriers adopt digital technologies throughout their businesses. The benefits of digital technologies will come from more tailored customer experiences, more efficient functions, and improved nimbleness across airline planning, customer, operation and enterprise operations.

Furthermore, by applying digital technologies to the whole value chain, airlines can reap their share of value through expansion, efficiencies and value chain disruption. Expanding outside the current value chain and moving into adjacent areas will require strong partnerships with technology providers and cooperation through broad industry wide initiatives. For example, IATA’s NDC and ONE Order initiatives have exposed opportunities for simultaneous disruption and expansion to take place in the distribution and merchandising arena. Airlines and technology providers are rapidly advancing different solutions to capitalize on the opportunities.

When travel is a personalized, context-aware and frictionless experience without “turbulence” of any sort, we believe customers will respond in large numbers. Whether it be anticipating customer needs in the traditional airline environment or working across the travel ecosystem, digital technologies enable airlines to treat passengers less like a captive audience—and more like valued guests. One without the other will not get airlines to frictionless travel and renewed, sustainable profitability.
Future airline leaders will seek to:

1. **Create frictionless and personal travel experiences**
   Digital technologies such as AI, analytics and IoT will allow leading airlines to deliver on customer expectations by providing personalized, frictionless travel.

2. **Invest in digitalizing operations**
   Analytics and real-time intelligence are critical for airlines to eliminate inefficiencies in core airline operations. Those same technologies can help them gain operational efficiencies within support functions such as finance, human resources and information technology.

3. **Collaborate to create new fields of value**
   To own the end-to-end travel experience, airlines must collaborate with partners across the travel ecosystem. Forward-thinking leaders leverage these relationships to redefine their competitive advantage.
AUTHORS

John E. Luth  
Chairman & CEO  
Seabury Consulting, part of Accenture

Jonathan Sullivan  
Managing Director  
Seabury Consulting, part of Accenture

David Walfisch  
Principal Director  
Seabury Consulting, part of Accenture

REFERENCES

1 ASCEND
2 IATA Direct Data Solutions
3 Innovata
4 Innovata
5 Seabury Consulting analysis
6 IATA Direct Data Solutions
7 Innovata
8 Innovata
9 Innovata

ABOUT ACCENTURE

Accenture is a leading global professional services company, providing a broad range of services and solutions in strategy, consulting, digital, technology and operations. Combining unmatched experience and specialized skills across more than 40 industries and all business functions — underpinned by the world’s largest delivery network — Accenture works at the intersection of business and technology to help clients improve their performance and create sustainable value for their stakeholders. With 477,000 people serving clients in more than 120 countries, Accenture drives innovation to improve the way the world works and lives. Visit us at www.accenture.com.

FOR MORE INFORMATION

www.accenture.com/seaburyconsulting

Copyright © 2019 Accenture.  
All rights reserved.  
Accenture and its logo  
are trademarks of Accenture.  
This document is produced by consultants at Accenture as general guidance. It is not intended to provide specific advice on your circumstances. If you require advice or further details on any matters referred to, please contact your Accenture representative.