

Airlines achieved some of the widest margins between unit revenues and costs in 1998. But cost reduction is only half the battle. Revenues and the cost of generating them is coming under close scrutiny.

# Yields & revenues in small slide despite Asia crisis

**N**ow that airlines have managed to achieve a wide margin between unit revenues and costs, a feat which delivered record results for many in 1998, a key element to profitability is unit revenue.

Nevertheless, costs have been under attack for decades, and while there is still scope for improvement, the single element of revenue is half the profitability equation. Competition is constantly putting downward pressure on revenues, but airlines are fighting back with alliances, electronic ticketing and reductions in commissions and cost of distribution.

Airline alliances boast the dual advantage of increasing traffic and load factors while at the same time reducing costs. Increased traffic and load factors in turn improve unit revenues.

While financial analysis has always focussed on unit revenues and yields, there is little information about passenger revenues net of distribution costs. The cost of selling seats and generating revenues is hidden among the cost elements of commissions, staff and information technology, and in other areas.

While airline results make it impossible to decipher how much is being spent on ticket marketing and distribution and revenue collection, many airlines do quote sales commissions in their annual results. Passenger revenue net of sales commission is useful in illustrating how efficiently an airline is selling its seats.

Unit yields and passenger revenues are expressed in terms of per revenue

passenger-mile (RPM) and available seat-mile (ASM). Unit yield therefore gives an indication of the fare level the airline is achieving on its network. Unit revenue gives an indication of how fares are diluted by load factor and also how revenue is spread across units of production (ASMs) and how this compares to unit costs.

Airlines in different parts of the world have different cost and fare structures. Airlines within these global regions also have different marketing potential, styles and quality of management, type of operation, serve different markets and have different corporate strategies.

## North America

The passenger airlines in North America probably have the most diverse range of styles. These airlines can be divided broadly into the categories of major, secondary, no-frills and regional. The airlines within each of these groups compete closely with each other and have similar strategies and cost structures.

While US Airways has the widest margin of 1.8 cents between unit revenues and costs, it also had the highest unit yield of 17.1 cents per RPM and passenger revenue of 12.5 cents per ASM (see table, page 27).

All airlines in the US have improved their load factors in recent years. Even US Airways' high fares did not prevent the airline achieving a load factor of 73.0% in 1998.

All other major airlines in the US had unit yields of less than 14.0 cents per RPM. The airline with the next highest

yield after US Airways was American at 13.5 cents. It also had the next highest unit passenger revenue of 9.5 cents per ASM.

While American was the second highest-performing airline in terms of yield and revenue, it was closely followed by several other majors. Alaska, Continental, Delta, Southwest and United, all come close to American in terms of unit yield, revenue and load factor.

All major carriers in the US, with the exception of Southwest and Continental, saw their cost of commissions reduce in 1998, while their revenues increased. In an effort to reduce the costs of marketing and distribution, US airlines have capped travel agents' commissions. These were typically about 7% of passenger revenues for US carriers in 1998. A reduction in commissions has led to higher unit yields and revenues over 1997.

The reduction in commissions and increase in load factors combined to increase unit revenues and yields by up to 0.40 cents in some cases. Despite the effort put into reducing commissions and costs of distribution, the improvement in load factors was the main factor responsible for raising unit yields and revenues.

America West and Northwest had marginally poorer results than the other major carriers. Northwest suffered a pilots' strike and America West is the only US major that has a unit cost close to no-frills carrier Southwest.

Less than half the US majors actually experienced a rise in unit yields. The change over the year in unit revenues was better, however, for most airlines.



*European no-frills airline Virgin Express has managed to achieve unit yields and revenues as high as some major European carriers.*

Again, this means that an increase in load factors allowed a drop in fares to be compensated for.

Southwest experienced a small rise in commissions, despite having dramatically increased its percentage of seats sold through the Internet in recent years. The increase in Southwest's revenue was about 9 percentage points compared to a 3% rise in commissions, illustrating that Southwest managed to reduce its cost of distribution in 1998. Southwest's commission costs are also a lower percentage of passenger revenues than that of the other majors.

Despite being a low-fare, no-frills airline, Southwest achieved a unit yield at the same level as United, Alaska, Continental and Delta. Southwest's unit revenues were also in the same league as those of the US majors. The difference between Southwest and all other major carriers is the revenues the majority of these airlines derive from other group activities. While these activities derive extra revenue, they also incur additional costs. Overall, the margin between unit revenues and costs differs little between the majority of US majors and Southwest.

Unit yields and revenues generated by US regionals illustrates their high fare structures (see table, page 27). High fares is one area limiting load factors to less than 60% and this also dilutes unit revenues. Like the majors, there is a similarity in unit yields and revenues between US regionals.

American Eagle, which is reported together in AMR Corp with American Airlines has the highest unit yields and passenger revenues of all US regionals.

This illustrates the benefit the carrier gets from direct traffic feed from American.

All other regionals have unit yields and revenues about 5.0 cents less than American Eagle. The similarity in unit yields perhaps indicates that the fare structures of the airlines are similar, despite each one operating in a different region of the US and experiencing different levels of demand and competition.

## Europe

Like financial results and the margin between unit revenues and costs, there is a higher degree of variation in unit yields and revenues between major European carriers than there is between the US majors. There is also a strong correlation between profitability and unit yield and revenue.

The variation in yields between airlines is explained by the wider range of competition faced by European majors, the difference in geographical position and market access and national economies and the differing reliance on subsidies.

Unlike most US airlines, the majority of European carriers have experienced a rise in yields and revenues in 1998, or have been able to prevent a fall over the previous year.

Swissair has the highest unit yields and revenues (see table, page 28). The airline is privately owned and experiences little or no local competition. It has a high fare structure, but still has to compete bilaterally with other airlines. Swissair also has the widest margin between unit revenues and costs (see US airlines enjoy best year, page 11).

Swissair is part of an alliance with Austrian and Delta. These three carriers have experienced appreciable growth in revenue in the past three to four years since their alliance. This has improved their transatlantic and long-haul revenues, which have increased at a faster rate than traffic.

Swissair's high unit revenues and yields can also be attributable to the power an alliance has to increase traffic and revenue.

Lufthansa has the second highest yields and revenues, indeed these have always been high, even though the airline has recently become a key member of the Star alliance. The airline also has the second highest margin between unit revenues costs. Like Swissair, Lufthansa faces little local competition, but still has to compete with other airlines. Lufthansa's unit yields and revenues have increased by about 0.50 cents between 1997 and 1998.

Lufthansa's high passenger yields and revenues are further supported by about another \$5.5 billion in revenues from a host of other activities in the Lufthansa Group. This raises total unit revenues higher than those of most other European airlines and makes Lufthansa the most profitable European carrier.

Like Swissair and Lufthansa, British Airways has a correlation between profitability margin and unit yields. BA has the third highest unit revenues and yields, but the fourth highest unit revenue and cost margin.

BA's unit yields and revenues both shrunk by 0.75 and 1.00 cents, respectively, between 1997 and 1998, despite load factor remaining stable.

## SUMMARY OF US MAJOR AND REGIONAL AIRLINE PASSENGER REVENUE AND YIELD DATA

| Airline                        | Alaska | America West | American Airlines | Continental | Delta   |
|--------------------------------|--------|--------------|-------------------|-------------|---------|
| Passenger revenue \$m          | 1,410  | 1,858        | 14,740            | 6,824       | 13,289  |
| Regional passenger revenue \$m | 329    |              | 1,139             | 574         |         |
| Total revenue \$m              | 1,738  | 1,858        | 15,879            | 7,398       | 13,289  |
| Commissions \$m                | 99     | 127          | 1,232             | 594         | 968     |
| Revenue-Commissions \$m        | 1,639  | 1,731        | 14,648            | 6,804       | 12,321  |
| RPMs-mm                        | 11,248 | 16,406       | 108,875           | 53,908      | 103,419 |
| Regional RPMs-mm               | 1,114  |              | 2,778             |             |         |
| ASMs-mm                        | 16,777 | 24,317       | 155,324           | 74,769      | 142,082 |
| Regional ASMs-mm               | 1,795  |              | 4,516             |             |         |
| Load factor                    | 67.0%  | 67.5%        | 70.1%             | 72.1%       | 72.8%   |
| Regional load factor           | 62.1%  |              | 61.5%             |             |         |
| Unit yield c/RPM               | 12.5   | 11.3         | 13.5              | 12.7        | 12.9    |
| Unit revenue c/ASM             | 8.4    | 7.6          | 9.5               | 9.1         | 9.3     |
| Regional unit yield c/RPM      | 29.5   |              | 41.0              |             |         |
| Regional unit revenue c/ASM    | 18.3   |              | 25.2              |             |         |

| Airline                 | Northwest | Southwest | United  | US Airways |
|-------------------------|-----------|-----------|---------|------------|
| Passenger revenue \$m   | 7,670     | 3,962     | 15,550  | 7,794      |
| Commissions \$m         | 701       | 163       | 1,312   | 482        |
| Revenue-Commissions \$m | 6,969     | 3,799     | 14,237  | 7,312      |
| RPMs-mm                 | 66,963    | 31,445    | 124,527 | 41,449     |
| ASMs-mm                 | 91,154    | 47,484    | 173,897 | 56,749     |
| Load factor             | 73.5%     | 66.2%     | 71.6%   | 73.0%      |
| Unit yield c/RPM        | 11.4      | 12.6      | 12.5    | 17.1       |
| Unit revenue c/ASM      | 8.4       | 8.3       | 8.9     | 12.5       |

| Airline                 | ASA   | Atlantic Coast | Comair | Mesa Air | Skywest |
|-------------------------|-------|----------------|--------|----------|---------|
| Passenger revenue \$m   | 400   | 285            | 621    | 413      | 259     |
| Commissions \$m         | 38    | 44             | 47     | 58       | 26      |
| Revenue-Commissions \$m | 362   | 242            | 574    | 355      | 234     |
| RPMs-mm                 | 1,041 | 793            | 1,824  | 1,241    | 745     |
| ASMs-mm                 | 1,865 | 1,411          | 3,002  | 2,289    | 1,464   |
| Load factor             | 55.8% | 56.2%          | 60.8%  | 54.2%    | 50.9%   |
| Unit yield c/RPM        | 38.4  | 36.0           | 34.0   | 33.2     | 34.8    |
| Unit revenue c/ASM      | 21.4  | 20.2           | 20.7   | 18.0     | 17.7    |

Source: Merrill Lynch

## SUMMARY OF EUROPEAN AND ASIA PACIFIC PASSENGER YIELD AND REVENUE DATA YEAR END 1998

| Airline                        | British Airways | KLM    | Lufthansa | Swissair | Virgin Express |
|--------------------------------|-----------------|--------|-----------|----------|----------------|
| Passenger revenue \$m          | 11,237          | 4,202  | 8,437     | 4,430    | 277            |
| Regional passenger revenue \$m |                 |        | 946       |          |                |
| Total revenue \$m              | 11,237          | 4,202  | 9,383     | 4,430    | 277            |
| RPMs—mm                        | 74,286          | 36,977 | 44,371    | 17,693   | 2,258          |
| ASMs—mm                        | 104,156         | 48,051 | 60,472    | 24,654   | 2,935          |
| Load factor                    | 71.3%           | 77.0%  | 73.4%     | 71.8%    | 76.9%          |
| Unit yield c/RPM               | 15.1            | 11.4   | 21.1      | 25.0     | 12.3           |
| Unit revenue c/ASM             | 10.8            | 8.7    | 15.5      | 18.0     | 9.4            |

  

| Airline                 | Emirates | All Nippon Airways | Cathay Pacific | Japan Airlines | SIA    |
|-------------------------|----------|--------------------|----------------|----------------|--------|
| Passenger revenue \$m   | 884      | 5,975              | 2,387          | 7,041          | 3,056  |
| Commissions \$m         | 156      | 654                | 92             | 920            | 320    |
| Revenue—Commissions \$m | 728      | 5,331              | 2,295          | 6,121          | 2,736  |
| RPMs—mm                 | 7,116    | 34,052             | 24,695         | 48,916         | 35,142 |
| ASMs—mm                 | 10,171   | 53,129             | 37,222         | 72,469         | 52,301 |
| Load factor             | 70.0%    | 64.1%              | 66.3%          | 67.5%          | 67.2%  |
| Unit yield c/RPM        | 12.4     | 17.6               | 9.7            | 14.4           | 8.7    |
| Unit revenue c/ASM      | 8.7      | 11.2               | 6.4            | 9.7            | 5.8    |

Source: Merrill Lynch

This illustrates the effect of lowering average fares as BA experiences a decrease in premium traffic.

As with its financial results, BA's decreased yields are a direct result of local competition from fast growing no-frills airlines in Europe, particularly in the UK. However, the strength of sterling during 1998 must take some of the blame. Unlike US carriers, BA has made no visible reduction in sales commissions.

KLM has considerably lower yields and revenues than BA, but it has a higher revenue and cost margin. KLM's profitability is explained by its low unit cost and not its unit revenue, as with the case of other European airlines. KLM's yield and revenues have been diluted by 0.20 and 0.10 cents, respectively, between 1997 and 1998, while load factor has increased.

As with most other airlines an increase in load factor and traffic appears to have been stimulated by lower fares. KLM's profitability has improved substantially from 1997 to 1998 and this is partially explained by a rise in revenues from other group activities. While unit revenues for the group rose so did unit costs, but KLM managed to widen the

margin and make a large improvement to its profitability.

Despite a large increase in unit yield and revenue by 0.90 cents, Virgin Express suffered a reduction in profits. The margin between unit revenue and cost reduced by 0.36 cents to 0.04 cents from 1997 to 1998. Compared to the European majors, Virgin Express has impressive unit yields. It has a unit yield 0.9 cents and unit revenue 0.7 cents higher than KLM, for example. Virgin Express's unit revenue is also only 1.4 cents less than BA's.

Unlike the majors, however, Virgin Express suffers from a lack of other group activities that are relatively profitable to passenger operations for the majors. Virgin also experienced a sharp rise in unit costs of 1.4 cents. Much of this has been explained by a shortage of pilots and this has been blamed for most of Virgin Express's problems in 1998.

### Asia Pacific & Middle East

Unlike with European airlines, there is little or no correlation between unit yields and profitability. In fact, there is currently an inverse relationship between

unit yields and profitability in the Asia Pacific. All Nippon Airways (ANA) and Japan Airlines (JAL) have the highest unit yields and revenues, as they have always done, but are currently among the least profitable.

Emirates has strong yield and revenue performance, although both declined from 1997 to 1998. Like most other airlines during 1998, Emirates managed to reduce unit costs at a faster rate and to improve its profitability. Emirates does, however, spend 17.6% of its passenger revenues on commissions and this is high compared to all other airlines.

ANA suffered more than a 2.0 cents drop in unit yield and a 1.50 cents fall in unit revenue. This corresponded with a fall in margin between unit revenue and costs to zero cents during 1998, giving the airline a small profit of just \$5 million. ANA spent about 10% of its passenger revenues on sales commissions, a relatively high percentage compared to the US majors. One area of costs in which ANA could still make improvements is clearly ticket distribution and marketing.

Like JAL, ANA has suffered the consequences of the Asia Pacific crisis, although JAL's problems appear to be less

*All Nippon Airways suffered one of the largest falls in unit yield and revenue of all airlines in 1998. Japan's Economic problems and increased local competition were two factors.*

than ANA's. Both ANA and JAL have also experienced a sudden rush of competition in their traditionally protected local market.

A higher proportion of ANA's traffic is domestic compared to that of JAL. Consequently, ANA has suffered a higher fall in unit yield and revenue. ANA has also had to contend with Japan's economic problems and the difficulties this is causing traffic. This is another major factor in its rapidly falling yields and revenues. ANA did manage to reduce costs in 1998, but not fast enough to keep ahead of the fall in revenues.

JAL's unit yields, which have been lower than those of ANA, suffered a fall of about 0.9 cents. JAL's unit passenger revenues also fell about 0.9 cents. Despite this, JAL's costs fell by 1.6 cents per ASM and profitability improved. JAL has the second highest level of sales commissions as a proportion of passenger revenues at 13%. Like ANA, JAL has great scope for ticket distribution cost reduction.

JAL has suffered less from increased domestic competition but has also had to contend with Japan's economic difficulties. While the airline has managed to maintain a margin between unit yields and passenger revenues it still has to make a recovery from the Asia Pacific and Japanese crises.

Cathay Pacific also suffered falls in unit yield and passenger revenues as ANA; the largest falls of all airlines in 1998. The Asia Pacific crisis and collapse of confidence in Hong Kong after the handover to China has caused revenues to plummet. Unit yield fell by 2.0 cents; load factor reduced by a couple of percentage points. Traffic also stagnated. There is no clear sign of when Cathay may experience a recovery, although this will partially depend on improvements in the Asia Pacific economy. One factor in Cathay's favour is that the airline spends just 4% of passenger revenues on commissions.

Singapore Airlines (SIA), the most profitable carrier in the region, actually has the lowest unit yield and passenger revenue of 8.7 cents and 5.8 cents, respectively. SIA's position could be even stronger, since it spends 10% of passenger revenues on commissions.

The airline also has the lowest unit cost. SIA's fortunes are explained by the fact that it is basically a long-haul carrier



that operates widebodies alone. It therefore has the advantages of economies of scale, which keep unit costs low.

SIA is the only airline to experience a rise in unit yields, not only in the Asia Pacific but also in the rest of the world. While the rest of the region is experiencing a recession, Singapore's economy has continued to grow. The airline has also experienced a fall in load factor by three percentage points. The overall effect has been for unit passenger revenues to fall by about 0.15 cents. SIA's costs nevertheless also reduced by the same amount in 1998, preserving the airline's profitability margin.

## Summary

Almost all carriers experienced a fall in unit yields and revenues in 1998 over 1997. US airlines seem to have tackled the problem of sales commissions before others and 1998 was one of the first

years for this to happen. Developments in information technology have helped this, as have advances in electronic ticketing.

Some parts of the world still have to learn to cope with competition, which will increase in the coming years, as is evident in Japan.

The Asia Pacific crisis, and the uncertainty it has caused, has spilled over into all other global regions and has been partly responsible for the drop in yields. Whether airlines will be able to recoup yield falls during 1999, when some of the economic uncertainties disappear, remains to be seen.

Yields and unit revenues have already made recoveries and increased year on year in the earlier 1990s. A lot depends on the Asia Pacific crisis and all eyes are now on Japan.

The good news for airline profit potential is that carriers are managing to control costs and margins and are improving their profit potential. **AC**