



# Prospering in the Next Normal for Airlines

## Article 1 - Airline Recovery Timing and Restructuring

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Series 1, No. 1 Published Tuesday, January 12, 2021 5:00 PM EST | Royal Pacific Consulting Group

### Overview

*This is the first in a series of articles examining the timing of an airline industry recovery following the COVID-19 pandemic and how best to restructure for that recovery.*

*Aviation is a cyclical business, but airline leaders and investors build that fact into their strategic planning. However, the 2020 worldwide pandemic has introduced an unprecedented correction into the market. It is not about riding out the trough or hoping to return to the way things were before COVID-19. What this correction has introduced is a requirement to re-tool and rebuild for the “Next Normal”. Our analysis indicates that the customer will drive how airlines recover in the Next Normal. They, along with governments, will set the timing. Customer demands have been changing for the past few years and successful companies who understand the new customer will tailor their businesses to attract, not only returning travelers but new ones as well. To do so, successful airlines will have to intently focus on revenue, technology, partnerships, and company culture while still maintaining cost discipline.*

### Airline Recovery Timing

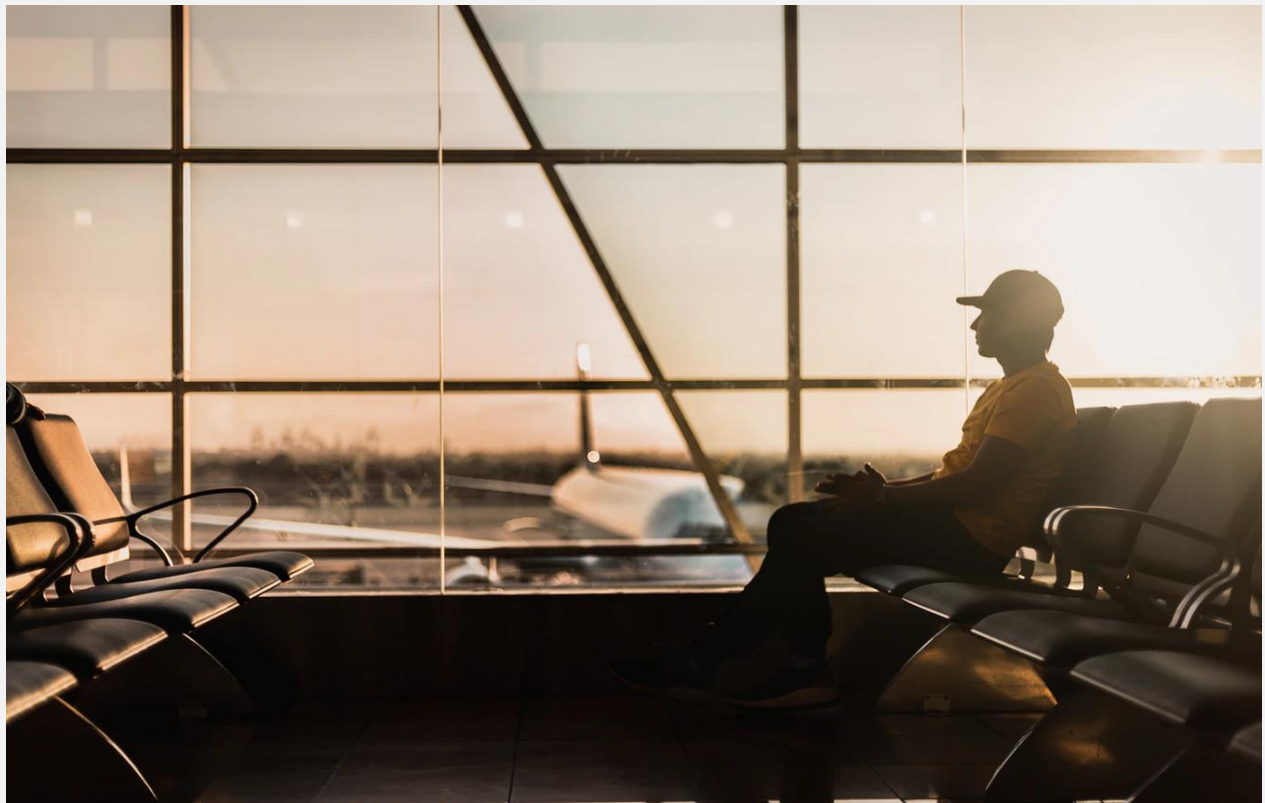


Photo by Marco Lopez



After a record ten-year long, positive run in the airline industry, there were people who had forecasted that the eventual downturn would be incident driven.<sup>1</sup> Even so, the airline community did not feel the collapse of our industry would be in 2020, and no one thought this current crisis would be caused by a worldwide pandemic. Heading into 2020, the industry was profitable and there was no emerging threat to the economy.

Nevertheless, the inevitable happened. In March of 2020, the world's airlines experienced the largest reduction in passenger revenue, ever, as a global pandemic was declared, and governments restricted their citizens' movements in an effort to contain the spread.<sup>2</sup>

The industry will recover, but serious questions need to be answered as the airline industry is facing a "reset". Only those who are ready for the new way of doing business post-COVID-19 will prosper.

### Emotional Based Recovery

The events of 9/11 stole nearly 3,000 lives.<sup>3</sup> The security deficiencies that led to these terrorist acts were quickly discovered and remedied. Despite the rapid security fixes, millions of people refused to fly for years after. It took until July of 2004, nearly three years later, that the USA passenger load factors reached their pre-9/11 levels.<sup>4</sup> This is compared to after the 2008 USA financial crisis, when the US airlines took only two years to return to profitability.

It is felt that the extended period taken for the airlines to recover in 2001 was based on the "emotional" fear of flying created by watching, hundreds of times in the media, the two hijacked airliners crash into the New York World Trade Center towers and the resulting war images chasing down those who supported the terrorist events. Whereas, after the 2008 financial crisis, people were not afraid to fly, they simply did not have the money to travel.<sup>5</sup>

The 2020 reduction in flying was caused by government travel restrictions and, most importantly, an emotional public response to an unseen enemy (COVID-19). Previous pandemics have produced very high death rates. For example, the bubonic plague pandemic of the 1300's in a one-year period is estimated to have created a death toll equal to fifty percent of London's population.<sup>6</sup> In New York city, COVID-19 has claimed well below 1% of the city's population. Most of these COVID-19 deaths have been confined to the elderly. Although every COVID-19 death is a tragedy, there are those who argue that the crisis could have been handled differently with less impact to the airlines. Regardless of these arguments, the reality is the world's governments have and will close external and internal borders to travel and the public is afraid of COVID-19 either personally or as a spreader of the disease to the more vulnerable. This can be classified as an emotional response.

Therefore, if the government travel restrictions are lifted in 2021, the next hurdle will be passenger confidence in travel and within an aircraft. In March 2020, airlines immediately addressed the onboard transmission of infectious diseases by deep cleaning their aircraft throughout the day, mandating face

#### Key Points to Understanding the Recovery

1. When will the airline recovery truly begin?
2. How should the world's airlines restructure to meet the post COVID-19 demands?
3. What airline product is required?
4. What type of management skills are required to prosper?
5. What are the financial priorities?



masks for all passengers and staff, using social distancing, suspending food and beverage services, conducting temperature testing, and questioning passengers for COVID-19 prior to flight. Yet, despite these new measures as well as aircraft high backed seats and advanced air circulation and filtration systems, most passengers did not fly on routes that were open – not affected by government restrictions. The airlines could do no more to provide a safer environment for their passengers, yet the emotional fear of flying during a pandemic was greater than any facts or statistical based arguments.

The trap many airlines may fall into is planning to ramp up capacity based solely on the COVID-19 vaccinations that have begun to be distributed. Western governments are estimating they will need all of 2021 to vaccinate their citizens for COVID-19. Also, worldwide travel is predicated on non-western countries having vaccinated their citizens. For example, in the USA, it is estimated that enough people will be vaccinated by the fourth quarter of 2021 for that country to have herd immunity.<sup>7</sup> Less fortunate will be non-western countries that are scrambling to secure the vaccine and will have herd immunity dates well past that of the USA.<sup>8</sup> In fact, the World Health Organization (“WHO”) has recently stated that COVID-19 should be considered endemic, or in other words will continue to resurface and will not be eradicated. Thereby, in early 2021, the COVID-19 vaccine will be seen as simply another safety precaution to combat the coronavirus. During 2021, we can expect new strains of COVID-19 to be discovered, additional waves of COVID-19 outbreaks that will create regional lockdowns and the pandemic to stay topical in the media.

Nevertheless, it is estimated by the International Civil Aviation Organization (“ICAO”) that 2021 will see more airline passengers than 2020, but less airline passengers than 2019. As the summer returns to the northern hemisphere and other events occupy the media cycle, there will be an increase in domestic passenger demand. However, as winter approaches another COVID-19 wave may return in the northern hemisphere and the normal seasonal downturn may not be filled as usual by the leisure traveller seeking a sun destination. This is due to the time delay from the travel restrictions being lifted and the leisure traveller being able to coordinate their trip. In addition, much has been made of the pent-up demand for travel by COVID-19 fatigued individuals locked up in their homes. However, the desire of these individuals to travel has to be equally weighed against their disposable income to travel after over a year of reduced income in many cases.

So, when will it all end? Again, the lack of passengers is felt to be an emotional fear of travelling during a pandemic and the resulting government travel restrictions. Thereby, passengers will return to flying only after the COVID-19 pandemic is deemed defeated or determined “safe enough” by the WHO and governments. This will lead to travel restrictions being removed. However, the media will need to move on from their current widespread coverage of the coronavirus before the public will feel safe to travel once again. Based on the current facts, the first half of 2021 will continue to be difficult for airlines, with the second half of 2021 seeing more domestic passengers and possibly an increase in Canada/US trans-border flights with some improvement in international passengers if government travel restrictions are lifted due to successful vaccination results. The end of 2021 should see a significant passenger recovery in the southern hemisphere (the beginning of their summer) and throughout 2022 in the northern hemisphere will be when there should be a strong airline recovery in all but the international sector.

### **Sector Recovery**

If history repeats itself, as was the case in the USA airline recovery after 9/11, the first airline sector to recover after a recession is the Fully Independent Traveller (“FIT”). This occurrence was documented by



the US Bureau of Transportation Statistics. Logically, the next sector is the Qualified Independent Traveller (“QIT”) who is seeking a vacation or travel to a destination for a stay, followed last by the Organizational Dependant Traveller (“ODT”). The FIT passenger can make the decision to fly on their own based on desire, price and time allotted for the trip. Little planning goes into this person’s travel and the booking curve is normally short. An example, of a FIT traveller is a person Visiting Friends & Family (“VFR”), or a businessperson with the ability to authorize their own travel.

### New Terms for the Next Normal

Fully Independent Travellers can make the decision to fly on their own based on desire, price and time allotted for the trip.

Qualified Independent Travellers can make their own travel decisions but are dependent on someone else in the process. This may be the person’s company for their vacation time, or time to clear off the credit card so the bank will allow the travel charges.

Organizationally Dependent Travellers must demonstrate their need for any travel, comply with an organization’s travel policy, and obtain approval for their business trip from that organization

The QIT passenger can make their own travel decisions but is dependant on someone else in the process. This may be the person’s company for their vacation time, or time to clear off the credit card so the bank will allow the travel charges. An example of a QIT is the “Leisure” traveller who is seeking a vacation or travel to a destination for a one or two week stay. These travellers will factor in their desire to travel, overall travel cost, and time at destination, but they will need to coordinate a portion of the trip (e.g. vacation time off) with an external person/organization. As such they will need more lead time to plan their travel. This coordination can be in months but can also be years for lengthy international travel.

Regarding the ODT passenger, this person must demonstrate their need for any travel, comply with an organization’s travel policy, and obtain approval for their business trip from that organization. An example of ODT is business trips for large organizations or governments. Certainly, these organizations will be in cost cutting mode that will restrict business travel for years to come due to the financial recession that the COVID-19 pandemic has caused, but also due to shifting internal policies such on-line meetings.<sup>9</sup> The recent public shaming, and firing, of prominent people who traveled over the 2020 December holidays, demonstrates the emotional bias against any form of travel during this pandemic.<sup>10</sup> However, as time goes by and the 2020 pandemic becomes more of a memory than a current event, organizations will relax their travel policies again as in person face-to-face meetings are much more effective in influencing human behaviour.<sup>11</sup>

**In summary**, the reduction in airline passengers starting in 2020 was and is the result of WHO policy, government travel restrictions, public shaming, company travel policies and individual passengers’ fear of contracting COVID-19 while travelling. The COVID-19 vaccination will eventually reduce the health risk enough that governments will relax, then eliminate, travel restrictions. The issue is timing.

Later in 2021, passengers should feel increasingly safer to travel again. Therefore, in 2021 ICAO is predicting more airline passengers than in 2020, but less total passengers than in 2019. The second half of 2021 will have more passengers than the first half of 2021 led by the FIT, with the domestic/trans-border travel returning significantly in 2022 led by the FIT and the QIT. 2023 should be a good year for domestic/leisure airline recovery as the result of the FIT and the QIT with all airlines doing well in 2024 with the increasing return of the ODT, and international travel.



## Airline Restructuring Due To COVID-19

By the late 1990's it was clear that every organization in the world required a computer upgrade before the clock struck midnight on December 31, 1999 – the Y2K crisis. Unsure of how the world's computers would work without a date system that would recognize the next century, individuals, companies, and governments raced to purchase new and better computer technology that had this capability. As a result, entering into the 2000's saw the western world with the computer platforms that led the way for major IT based companies to advance quickly. Companies like Apple, Facebook, Google and Amazon.

It is obvious that airlines were forced to reduce capacity and costs in March 2020. Older aircraft were sold off and an airline's balance sheet was critical to the airline's survival and investor confidence. However, this is not long-term restructuring, it is simply reacting to the reality of a worldwide pandemic that took, at times, 90% or more of the passengers out of the market.

Virtually grounded for a year, the airline industry will never be the same and "what was old" will remain "old". Barring any major setbacks with the COVID-19 vaccination program in 2021, the great airline reset will occur in 2022 and airlines should spend this down time to prepare. The following topics cover how airlines will need to think and act post-COVID-19.

### Airline Promises to Their Passengers

Airline passenger behaviours and attitudes have evolved over the past decade. Although price is still important, time is becoming critical in an age of short attention spans.<sup>12</sup> Issues like defined passenger rights, the environment, instant response technology, self bookings, social media reviews and even racism are front and centre of the public's psyche when selecting an airline.

Each airline will be slightly different, but the overall promises to passengers post- COVID-19 will be: a) a safe environment where the actual flight safety is guaranteed along with the prevention of infectious diseases; b) a secure environment that will defeat any physical threats to the aircraft or passengers by third parties; c) the highest level of environmental care and sustainability – the green aspect of the airline; d) reliability (operating on time); e) dependability (operating the schedule as sold); f) affordability for class of product and service; g) a seamless and convenient customer journey through all portions of the passenger experience; h) timely and fair customer service recovery; i) individualized customer experience and technology that will recognize the customer as an individual; j) a value proposition that guarantees the customer the lowest prices of third party products and services; and k) technology that will make the whole system work to best in class standards.

### Organization Shift

Increasingly, airlines do not have the luxury of being highly specialized. All airlines can offer a low-cost product (tighter seat pitch and unbundled ancillary revenue items), while at the same time offering an expanded range of products and services that will capture increased revenue from the same passenger. It will be the split between costs and revenue, not absolute values, that will dictate profitability. Retained profits that created a good balance sheet will be required to off-set steep economic cycles and the fact that governments have shown their reluctance to "bail out" distressed airlines. Airlines with poor balance sheets are at risk of failure in 2021, or at least the target of takeovers/mergers.



Increased product and services revenue will come from partnerships with other travel related companies, where their products and services will be sold by the airline in return for a commission. This is important revenue as there will be downward pressure on base airfare that cannot be replenished by airline ancillary revenue programs alone.<sup>13</sup> The theory is airlines of the future will attract customers that will be shared by their partners. The goal is to capture a growing percentage of a customer's Total Travel Spend ("TTS).

In fact, having five to six revenue streams will be critical for the post-COVID-19 airline. In reality, airlines should be seen more as on-line travel companies that control the flow of customers to their partners, who in return pay the airline a commission or other form of remuneration. This will favour airlines with a strong brand presence.

### **Customer Monetization Template**

Each airline passenger should be considered more than a single transaction customer. Not only will a longitudinal relationship be required with these passengers, but the airline must control their passengers' journey through their full TTS process.

By guaranteeing that the customer will not find better value on their own, the customer can be guided through other aspects of their trip spending such as travel financing, a taxi pickup, a car share ride, airport parking, on board food from in airport vendors, hotel rooms, car rentals, insurance programs, packaged tours, on board shopping channel purchases including products delivered to the customer's home or hotel after the flight. To better manage the longitudinal relationship with the customer, advanced club/loyalty programs are necessary to push out products to the passengers regardless of them flying on the airline or not.

In short, an airline in the new world will be valued not only on its passenger market share, but by its share of the TTS of each passenger and the travel industry.

### **Binding Technology**

As base airfares fall and ancillary, club/loyalty, and partnership revenue increase, it is technology that will bind these products and services together. The millennials as customers seek highly functional technology. They are information hungry, social media savvy, but have short attention spans.<sup>14</sup> Born from 1977 to 1995, it is expected that by 2025, 75% of the workforce will be millennials. Regarding centennials (Generation Z), born 1996 to 2015, they now make up 20% of the workforce. Centennials have lived their whole lives with the Internet and on average received their first cell phone at age 10. They are more conservative than millennials but have deep values in social and environmental causes.<sup>15</sup> Both of these customer groups will judge and use an airline by its interactive technology.<sup>16</sup>

The speed of which an airline can improve their technology to accommodate millennials, centennials and the new forms of revenue is paramount to their long-term survival and prosperity. Arguably a start-up airline will have the advantage in this regard as they can design their merchandising platforms with this in mind.



## Airline Leadership Mindset

A post-COVID-19 airline leadership team will need to understand how to market and sell to millennials and centennials and how to seek out other forms of revenue based on their control of their airline customers. They should see themselves as on-line travel companies that just happen to operate aircraft to attract passengers. These passengers are then turned into customers for the airline and all their partners. It is the sum of all forms of revenue and these partner relationships compared to its costs that will determine profitability.

For example, leadership will need to highly value a new partnership account as an increased form of revenue as compared to pre-COVID-19 when simply placing more seat capacity into the network was the objective. Although, these are actually simple solutions to obtaining more revenue, it is the technology which has been the obstacle. A post-COVID-19 airline leadership team must understand and use new technology to drive an increase in revenue and to reduce costs.

## Conclusion

Given the emotional nature of this recovery, airlines should see a recovery starting in the domestic sector the second half of 2021 and continuing into 2022. The recovery will start choppy with setbacks and then increasingly stabilise. Leisure travel to vacation destinations will follow and there will be an eventual recovery to international travel by 2024.

During the four years it will take to fully recover from the effects of COVID-19, our demographic will have changed. The primary airline customer will be the millennials and the centennials, with the millennials approaching their 50s. They will be focused on an airline reputation for environmental responsibility, ease of use in technology and immediate response to their inquiries. They will follow online reviews, book flights and associated travel items on their own and will be willing to use a single provider for much of their total travel spend.

Technology will create a broader revenue stream for airlines and a customer will be a financial asset that needs to be interacting with the airline even when not flying. Airline leaders will need to understand their new customers, the new revenue sources and how important technology will be to a successful airline. Lastly, airline leaders will need to create a trusted brand in all these areas.

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## End Notes

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