AIRLINE OUTSOURCING

Have the Airlines Outsourced All That They Can?

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INTRODUCTION

Since 2001, the airline industry has reported operating losses of approximately US$30 billion. The string of losses has been attributed to a series of events — most notably terrorism, SARS, conflict in the Middle East, a questionable global economy and the incessant climb of fuel prices. The management teams of all airlines are confronted with this loathsome mix of unwanted and unwelcome challenges. In response, airline executives are battling internally to devise ways to reduce costs and create a more variable and flexible operating model. With these challenges, these teams have no choice but to explore every avenue to generate cost savings, and outsourcing opportunities may be high on the list.

Major airlines understand that without top-line growth, bottom-line profitability demands strong cost cutting and innovative efficiency measures — and for most carriers, realizing benefits from these efforts is absolutely time-critical.

As the battle for customers has escalated, airlines have failed to strip all the excess capacity out of the marketplace, resulting in a weak revenue position.

Despite gradual annual growth in passenger traffic and revenues during the past decade, profits have been erratic, and shareholder value has suffered, lagging that of the overall economy. Since 9/11, airline carriers have tried a number of measures, including attempts to “right-size” their fleets and schedules, but as the battle for customers has escalated, airlines have failed to strip all the excess capacity out of the marketplace, resulting in a weak revenue position.

Becoming more price-sensitive, both leisure and business travelers have begun to embrace travel substitutes such as video and teleconferencing. Although the low-cost carriers gained market share and customer loyalty during the beginning of this time period, even they are now are fighting to restore the profits lost to surging fuel prices.

THE IMPERATIVE FOR AIRLINES

The message is that airlines, and legacy airlines in particular, must radically refocus and restructure their behavior and operations. To meet the challenges ahead, they must address several issues:

1. The need to embrace change at all levels of the organization.
2. The need to fundamentally alter the cost structure.
3. The need to rebuild customer relationships.

Not all carriers are going to survive the ensuing industry rationalization, and the daunting task facing these management teams is ensuring that their carrier survives and even thrives in the current environment. Yet, developing and implementing solutions to the issues airlines face will likely require external resources and additional investment.

This is one of the areas where outsourcing may help. At a time when airlines must unlock the value of their current operations to set the stage for long-term profitability, outsourcing allows top management talent to focus on a rigorous self-examination and redefinition of the airline's core enterprise without siphoning off top-management talent to focus on cost-cutting in the sourced areas. Top talent is needed to effectively operate the core business and exploit its underlying value drivers.

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Indeed, outsourcing is not a new concept for the airline industry; it has been implemented in varying degrees by most carriers. Historically, airlines have outsourced a variety of functions ranging from check in, to cargo handling, to information technology and even to flying itself. In addition to enabling management to focus on the core business, outsourcing has provided the following benefits to carriers:

1. Ability to leverage a service provider's scale, expertise and systems.
2. Lower labor and capital costs.
3. Higher quality and more stable processes.

With a proven track record and the promise of these benefits, outsourcing would appear to be a potent tool for confronting the cost pressures currently plaguing the airline industry.

Many of the large carriers have done their outsourcing in a piecemeal fashion — for example, more than half of all airplane maintenance is outsourced to contract mechanics, according to the U.S. Department of Transportation. However, outsourcing of non-core operations must be earnestly considered in light of industry realities. Reservations and customer service call centers, in-flight catering, human resources administration, finance and accounting, and information technology support now top the list as excellent candidates for outsourcing to third-party vendors.

Although information technology outsourcing is already commonplace in the industry, the leading edge on such deals has advanced considerably as evidenced by Star Alliance's recent multi-carrier deal for reservations processing provided by Amadeus. At a time when cost reductions are essential, many factors — such as redundant cost centers, rigid labor agreements, and the lack of compensation structures — continue to create complexities and inefficiencies that force airlines to investigate every potential cost-savings opportunity.

CONCLUSION

Resistance to outsourcing may be a bit like shaking a fist at the sky and telling it not to rain, even as you stand soaked by the downpour already in progress. Previous concerns about outsourcing and any perceived loss of control must be reconsidered now in the harsh light the current operating environment. Carriers that have current outsourcing experience will be analyzing potential opportunities with a practiced eye, and converting viable opportunities into real savings — and bottom-line success. As carriers less experienced with outsourcing are forced to take another look at it, they will be playing catch up with their competitors.

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With more than 25 years of experience in sourcing, Harvey is a sought-after global industry advisor with particular expertise in global sourcing strategies, digital transformation trends, governance and emerging service delivery operating models. He offers his clients insights gained from involved with some of the largest and most complex transformational sourcing initiatives in the industry. His experience includes working with the architecture of mergers, acquisitions and divestitures and designing creative transaction structures, such as cost-quality and outcome-based relationships. Harvey holds a degree in finance from Florida International University and an MBA from the University of Miami.

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