

AvNews

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LATIN AMERICA & CARIBBEAN

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Interview of The Month

Christopher Schmacke, Consultant, Lufthansa Consulting



The Hidden Potential of Belly Cargo
Lufthansa Consulting (LC), a leading management consulting company in the aviation sector, offers a wide range of services to airlines. Currently they are consulting a number of clients in the “hidden potential of belly cargo” and how it can make a positive difference for any carrier if managed properly. AvNews believes this is a story that will have broad interest among our subscribers and approached Lufthansa Consulting for an interview. Following is a response to our inquiry from Christopher Schmacke, Consultant, and Mirja Nissen, Director Sales Americas.

ancillary revenue comparable to selling duty free, or nowadays, sandwiches.

But this is not the case. You need **Christopher Schmacke** to have a completely different business plan to approach the cargo sector profitably.

AvNews-Why did LC choose to add this service at this time?

Because the old equation “if it fits in the aircraft, we transport it” does not work anymore. In general harmonization of services and industry standards are good things. It makes life and business easier especially if so many different players are involved in the value chain. Yet in air cargo this development was one sided. It has led to a simplification, especially for the forwarding industry, diminishing air transportation to a commodity as exchangeable as gas, yet with much lower margins.

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AvNews-Is this a new service from LC?

It is not entirely new, yet we approach the topic from a more strategic point of view. Especially with smaller carriers where the revenue stream from cargo accounts for only a small fraction of their overall income and where capacity so far doesn't seem to justify a dedicated BU strategy, they have treated belly cargo potential as

Commentary: *By Jared Harckham, Vice President, SH&E*



Jared Harckham

Improving Airline Profitability By Systematically Identifying and Reducing Hidden Costs

Airline managers in Latin America and around the world have become skilled at reducing obvious costs in order to compensate for falling unit revenue and rising expenses, such as fuel. Also, the more competition airlines have faced, the leaner they have had to become, or else face restructuring or liquidation. Some of the obvious cost categories where most airlines have taken action include commissions, booking fees, staffing levels, on-board meals, call center out-sourcing and aircraft re-negotiations.

such as Mexico, where fuel is provided by one, government-owned supplier. Best practice labor cost reductions have been evasive for many legacy airlines in Latin America – with legacy airlines in Argentina, Jamaica and Mexico finding themselves in this category. These shortfalls increase the need for creative cost reduction in other, less obvious areas.

In some Latin America-Caribbean markets, government regulations and protection have meant that even “low cost” airlines have not had to operate in the most efficient manner. For example, the recent opening of Brazil to deregulated domestic fares and more competition will mean that even the Brazilian “low cost” airlines need to review

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Some airlines around the world have had success in obtaining more efficient labor contracts, and some have been able to hedge their fuel effectively. In Latin America and the Caribbean, results in these areas have been mixed. Fuel hedging is not possible in some countries –

“One of the biggest obstacles to belly cargo was and still is its dependency on the passenger business.”

INTERVIEW OF THE MONTH

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We have stepped up this service and put it in the spotlight at the same time as fuel prices and demand for transportation skyrocketed making it a challenge to still earn money with simply transporting something. Now we have the opposite scenario, low fuel prices and declining worldwide demand. Though different in nature those scenarios have similar effect on the bottom line - profits are fading.

AvNews-Can a belly really make a difference?

A belly can absolutely make a difference - if approached properly. You do not have to be a large international legacy carrier to earn money with your belly. It is not the case that you generate more revenue and or profit with your belly the bigger you are as an airline. It is much more the strategy you are pursuing in combination with the right product offer tailored to your specific customer needs.

AvNews-How has the service been received by airlines worldwide?

So far this service has been received very well by airlines worldwide. Although larger carriers are a little more hesitant, we get more and more signals that our service is not just catering to the small and midsize carrier. Yet the later in general have, as mentioned already, put less effort into this business segment in the past than they acknowledge now they should have.

AvNews-Can you relate any actual success stories?

We are currently working with some carriers on this particular topic - one here in the US. Unfortunately we cannot reveal them for the time being as NDAs are in place. Yet it is also perfectly understandable that those carriers do not want to be identified as we are not talking about simple cost cutting arithmetic but in some cases completely new strategic approaches.

AvNews-How do you work with an airline client to develop a belly cargo hold strategy?

The first and most important thing is not just to understand your customer but to know who they actually are. Every market is different. On the passenger side most airlines understand their customers having used fancy market intelligence tools in order to learn even more about them. As cargo is so far “just” a by-product without clear strategy behind it, it simply does not receive the necessary attention. Even more, forwarders sometimes try to make it look like the entire world has an equal customer base with more or less similar requirements.

The second most important part is acknowledging the fact as a consultant that we are outsiders; not only

outsiders to the company but also outsiders to the company's culture. We always make sure that we do not forget the culture of a company. Neglecting this could also mean that the entire strategic approach would be wrong right from the get go.

AvNews-How does LC help a carrier choose a strategic approach; for example to be a tech leader or a price leader?

When I mentioned that we are incorporating the culture of an airline I also meant that we have to incorporate the investment ability of a company. Of course we examine the market and its players and demands to establish a very good knowledge of the requirements in this market place in order to be successful. Yet this then needs to be put into perspective in accordance with the client's organizational and infrastructure capabilities. A big limiting factor often comes from the infrastructure and third-party service providers.

You mentioned technology or price leader as strategic options. While Porter definitely had a valid perspective in this regard we try to go beyond this scheme. In the end it is all about distinction and that can also be a mix out of those two schools.

AvNews-What other aspects need to be considered by airlines besides strategy?

One of the biggest obstacles to belly cargo was and still is its dependency on the passenger business. This dependency leads to a tendency to treat the cargo space as given. It also leads to the wrong expectations. While transported by the same aircraft with the same crew, maintenance costs and capital costs, many managers do not expect cargo to cover the full range of costs. Just because a certain route is profitable from passengers only should not mean that every other type of business gets the asset for free. A simple example shows that we have a break in the logic. At what portion of the aircraft utilized for cargo instead of passengers do we start allocating all the cost items mentioned before allocating a fair share to cargo? 30%? 40%? Certainly if we hit the 50% mark and above we start asking for a fair contribution from cargo. So what is the difference if “only” 20% or less comes from cargo?

As a matter of fact, those airlines which adhere to the principle of creating value are better prepared to go through the rough time as they have set the right targets at the right levels for business while going through the good times. During this time they actually contributed to the overall company's return on their investment in aircraft.

AvNews-What is LC's advice for a carrier that wants to pursue belly cargo revenue?

Big is not beautiful. And revenue is only one side of the income statement. The ultimate goal for any carrier should be making the best use of its assets - the airplanes. And regardless if it is core or non core business, it all has to contribute to provide a return on the asset.

Know your customer, have the right strategy in place but also steer your company by the right measures and indicators. Get in the business of value creation instead of transportation.

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