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Wet lease agreements – Universal remedy for airlines post crisis or risky business

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The business of leasing aircraft

The main business of airlines is flying planes from A to B with passengers or cargo. There are various developments that can make a customer journey better and airlines more efficient and profitable, be it cooperating with partners in interline and codeshare agreements or joint-ventures. However, that main component of flying an aircraft from one location to another has recently seen shifts when it comes to the entity that actually owns the plane and hires the operating crew.

Whether used as a mere financial measure through a financial leasing agreement (e.g. sale & leaseback) or through actual short-term leases for peak periods, wet lease agreements have increased in popularity. A trend in the recent years has been to go further and rather than leasing just the aircraft, leasing the entire operation from aircraft to crew to maintenance and insurance (ACMI).

This additional flexibility has proven to be crucial in 2020 when demand plummeted and passenger levels are not expected to reach pre-crisis levels until 2024 or 2025. Rather than cancelling and therefore often writing-off own assets in a demand down-turn as we have seen with COVID-19, a leasing agreement acts as an initial buffer on top of the fully owned supply.

This model has been a staple of the U.S. industry with regional carriers such as Republic Airways continuously operating for American, Delta and United. In recent years, other markets have been catching on to this trend, with both temporary replacements as well as long-term lease contracts. British Airways for example, temporarily replaced their 787s with wet lease capacity from Air Belgium in 2019, when aircraft engines had to undergo unexpected inspections. With the aviation world facing a period of the biggest uncertainty in its history regarding short and mid-term travel levels, the question arises whether ACMI agreements are a sustainable tool in a post-COVID market.

The allure of wet lease agreements for airlines

Wet lease agreements can be a beneficial tool for airlines especially when it comes to increasing flexibility and reducing costs. These frameworks provide a relatively simple way of adding capacity to an existing network, whereas typically, for any given airline, the existing fleet is fairly set with limited ability to up or downsize quickly. Lessees do not need to worry about fleet harmonization; as economies of scale effects (crew training, complexity etc.) do not apply to such a setup. Therefore, wet lease agreements can and are often used to test new and different markets with limited risk attached.

At the same time, due to the nature of wet lease operations, leasing an aircraft might even be cheaper than operating own aircraft. Lower operating cost (measured in CASK - cost per available seat kilometer) can make destinations viable that would not be under main-line operations. In many cases, significantly lower costs and commitments for cockpit and cabin crew decrease the operational costs. Airline managers have to prepare for discussions with the unions, as wet leases may be considered a way of outsourcing.

Challenges of wet lease operations along the customer journey

Even though wet lease agreements can be a profitable business model for airlines, the management of the customer experience is a big challenge. Consistency and seamless integration of processes along the customer journey is a complex task:

Plan & Book:

Often, the unclear brand value of the new AOC (Air Operator Certificate) leads to customer confusion through marketing efforts and a misunderstanding which booking channels have to be used.

A great challenge lies in the availability of ancillaries (seat, bag, upgrade, lounge, on-board dining). The different operations may lead to initial compromises that will impact profitability as ancillary revenue and customer loyalty and satisfaction are reduced. Furthermore, mostly due to the legacy IT environment, the smooth integration into the various customer touchpoints, ranging from web, app to personalized mailings is far from effortless.

Pre-Flight:

Arriving at the airport, the first challenge passengers face is the question, which counter they have to go to for check-in and baggage drop off. Due to the blurred brand experience, passengers might not have understood during the booking process, which entity they are going to fly with.

Flight:

While passengers might book with one airline, thinking they will fly with that specific brand and service level, a (negative) surprise might be waiting for them at the gate when the entity, and thus the aircraft and crew of their flight is an entirely different one. Especially the on-board product such as catering, inflight entertainment and the restriction of personalization efforts compared to the main line product often lead to passengers being disappointed.

Post-flight:

After the flight, and especially true if an IRREG occurred, the customer relationship management and its communication channels may not be able to provide equivalent service to impacted customers, e.g. due to missing information about delays or with unclear responsibilities and multiple transfer services. Such an experience will leave customers with a negative association with the brand.

Hence, many airlines have faced the challenge of unclear market positioning and blurred brand value with the result of unhappy passengers and limited customer retention.

Rethinking wet lease agreements with a focus on customer experience

In a post-COVID market, brand identification and customer experience will be key especially for legacy carriers in their quest to fend off low-costers aggressively trying to win over market shares. Therefore, especially legacy carriers have to ensure wet leases do not harm their customer experience:

Transparent Communication:

As the customer plans and considers booking options, any airline with wet lease operations should aim to have a clear distribution strategy:

- making use of the largest possible booking window (thus, loading the flights into the schedule as soon as possible to not miss out on bookings)
- avoid "changing" the operating carrier (e.g. from mainline to wet lease) half-way through the booking window so customers will fly what they have booked
- transparent communication of the wet lease in the booking channels, especially if the product delivery is different than the mainline (similar to how codeshare and interline flights are shown; "operated by American Eagle")

Seamless travel journey:

The biggest challenge that can occur is the disappointment or surprise of passengers when they see the difference between the operating carrier's product to the main-line product they were expecting and are maybe even used to. The development of a clear brand and product strategy with either a matching brand and product or a sub-brand with similar product offering will help customers navigate through the new experience and avoid widening the gap of customer expectations. Best case, customers don't realize that the operator they are flying with is not the same entity than the one they booked their travels with.

Consequently, the product definition and alignment between the lessor and the lessee should be considered far in advance. Defining the strategy and then following through is key. In case of irregularities, lessor and lessee have to have a plan in place. Just switching the aircraft with a main line lessee operation may not be an option. Complex IT setup will further complicate things. The goal should be to be able to handle an IRREG including quick rebooking and retaining passenger services (ancillary, seat reservation, service request such as wheelchair etc.).

Simplification of customer processes:

Between booking and departure, airlines in the recent years/decade have been pursuing various simplification as well as personalization efforts across multiple touchpoints. Simplifying these processes will ensure a smoother journey for customers and at the same time reduce complexity and lower the costs for the organization. Creating a joyful, easy and harmonized customer journey from advertising efforts all the way through to post flight communication is key to success.

Wet leases post-COVID: What will the future hold?

It is yet too early to quantify the full cost or further development of the crisis. However, the composition of the market in the "new normal" is expected to change vastly and various trends will drive the aviation industry in the next years: A faster recovery for leisure travel compared to a reduced demand for corporate business travel will allow for a shift in AOC's and foster new AOC's in the leisure and holiday sector. With the focus on cost reduction, especially legacy carriers should not lose focus of their customers and their needs. Attracting and retaining leisure passengers will be the driver to prosper in this highly competitive market; and not delivering on customer expectations can hinder success.

From a business model perspective, wet leasing is an opportunistic, flexible and competitive tool that can function well in the "new normal". However, airlines will need to adapt their strategic thinking on how to use their wet lease operation. If airlines want to be perceived as a valuable brand and service provider and not as a simple producer of a commodity that is advertised and sold by companies such as google and amazon, they will need to assert themselves in the market as own strong brands, otherwise they will slowly destroy their business model in the future. Ultimately, wet lease agreements could be one of the forward thinking and success driving tools in the next decade if implemented with a focus on customer centricity.

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