The future of airline business models for Africa post-COVID

Becoming a master of survival in the African airline industry

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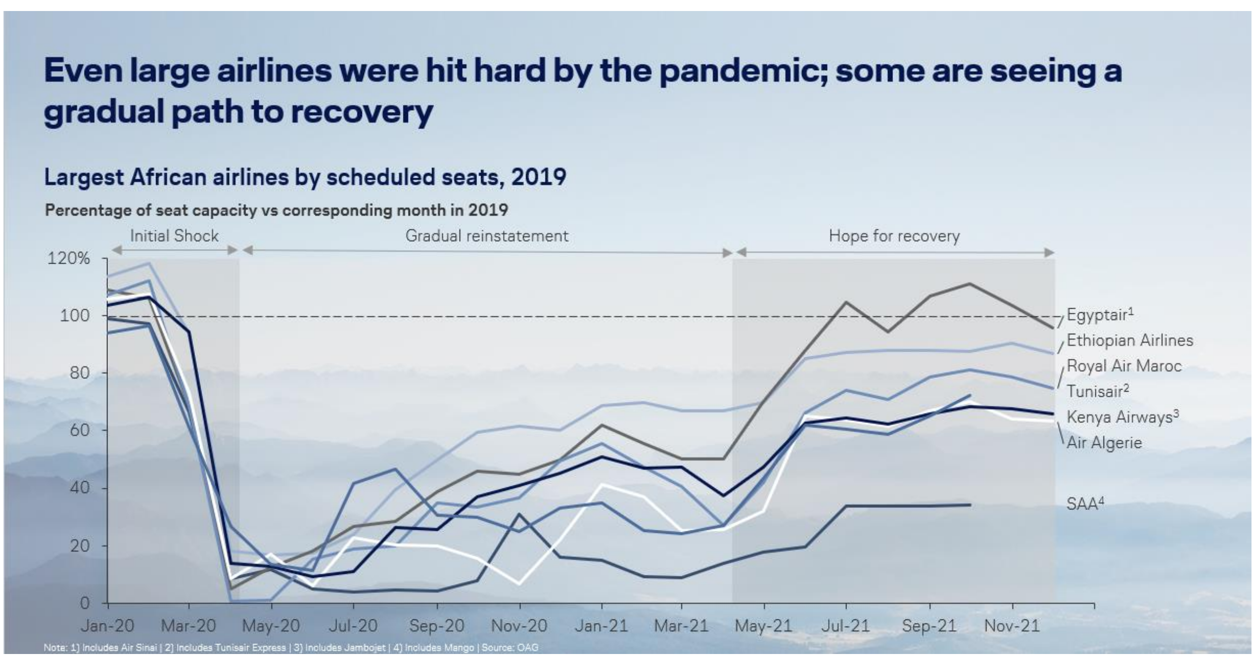
The African aviation market has always been promising and filled with opportunities, yet operating in this environment is challenging. It is a fast-growing market in which air connectivity went up by 30% from 2014 to 2019. Africa has a large, young workforce that can drive economic growth and which brings velocity to digital innovations. The continent has skipped certain stages of digitalization and jumped right into the mobile world. Coupled with the entrepreneurial spirit seen across the continent, African travelers have adopted smart, digital solution such as micro money platforms.

Nonetheless, this market also poses a set of unique challenges. In 2019, Africa made up 12% of world population, but only 2% of passenger air traffic. Africa is the most expensive environment on earth to operate an airline. This is mainly driven by market access limitations and high operational cost. In some areas the governments charge high user development fees and the overall fueling costs are expensive. For domestic travel the prices for mandatory COVID-19 tests were unreasonably high and have made travel within Africa even more costly.

Looking forward, which developments can be expected in the future?

African Airlines were hit hard by the pandemic with capacity dropping to 20% or less of 2019 levels. Most are planning to produce below 80% levels compared to 2019 by the end of 2021. With vaccines being administered in global markets and being identified as one key driver, we are now just entering the phase of recovery. The slow vaccination rate in Africa (just 4.2 doses per 100 people, compared to 77 for North America and 76 in Europe[i]) will be a major challenge going forward.



African Airlines are facing the questions of how they can use this crisis as an opportunity to transform their business model. In their search for answers, airline managers need to take an investors perspective on their own enterprise and evaluate two main dimensions.

First, how future-ready is their business model and was it working before COVID-19 struck? Secondly, will it work in the post COVID environment where so much has changed? Depending on the answer, airline managers need to evaluate whether implementing balance-sheet optimizing and cash-saving measures will be sufficient or whether a transformation of the business model is necessary to become a master of survival.

To shape your business for the future, consider your position and your purpose

The goal is to create the most effective and efficient business model which fulfills the company's strategic purpose or mission. Lufthansa Consulting expects that there will be room for all types of business models in Africa in the future: Full Service, Hybrid, Low-Cost and Ultra Low-Cost carriers. When defining their new business model, airlines need to consider how the new normal will shape up, which segments they can serve best and where they see the greatest potential. Business travel is expected to remain on a lower level as digital collaboration replaces personal business meetings. For anyone who travels post-COVID, health and environmental aspects will become more important. The competitive landscape will be severely impacted by the financial burden from the debts accumulated over the last year.

Some airlines will need to fundamentally change their business model. An example is Airlink in South Africa. The continued difficulties of the national carrier resulted in a vacuum in the market. This allowed Airlink to step away from its franchise partnership with SAA, launch independent operations under its own code, build new interline partnerships and set itself up for growth.

A set of key strategic questions should guide airline managers in determining an airline's future successful business model. Any discussion should start with the questions of what the airline's purpose is. Is it optimizing profits or may there be a more nuanced purpose? Airlines which are owned by public entities tend to serve purposes beyond optimizing profits, e.g., providing connectivity as a critical part of the country's infrastructure. Competitive business models are then based on specifically targeted customer groups in specific geographic regions combined with the best fleet to reach them. When these parameters have been clearly defined or reaffirmed, airlines should re-evaluate how their current network plans fit into the equation. For example, is an airline that is aiming for connectivity really adding economic value by serving international routes that increase the complexity of operations and severely hamper financial flexibility? Or, wouldn't it create more value to the country by being a focused, regional player with a homogenous fleet of small, efficient aircraft and partnerships in place that allow for global connectivity? Hub and spoke carriers on the other hand will need to evaluate point-to-point opportunities during the time of market recovery, and rethink their bank setup.

Moreover, all airlines are well advised to identify cargo opportunities. Ethiopian has shown how to quickly create a new business model as they turned passenger aircraft into "preigthers". Kenya Airways just became the first to modify a B787 passenger aircraft into a freighter.

One thing will ring true regardless of the airline's strategic purpose and scope. Airline managers will need to define the most efficient organizational setup to achieve their purpose in the future market. In this respect, the "real Low-Cost" business model in Africa is currently non-existent. At the moment, "LCC" in Africa appears to be a synonym for "low fares", but not the lean, efficient cost base that is the driver behind LCCs success in other markets.

How to shape your business model towards becoming a 'master of survival' in Africa

Lufthansa Consulting advises airlines to take action in 6 key areas in order to shape their business model, effectively fulfil their goals and become a "master of survival".

Be Flexible: Set up your organization along efficient processes with the flexibility and agility to ramp up or down production quickly and cost efficiently. Airlines need to be able to make opportunistic decisions faster than ever before, such as Ethiopian and Kenya Airways immediately implemented cargo operations.

Be Lean: Even in the biggest crisis in the aviation sector hardly any job cuts in Africa were observed, besides rarities like the cuts at Air Zimbabwe. With lower expected margins and lower production levels, it is paramount to be as efficient as possible in all aspects of the organization. Airlines should not be a tool for social welfare – other public institutions would be able to serve that purpose much better.

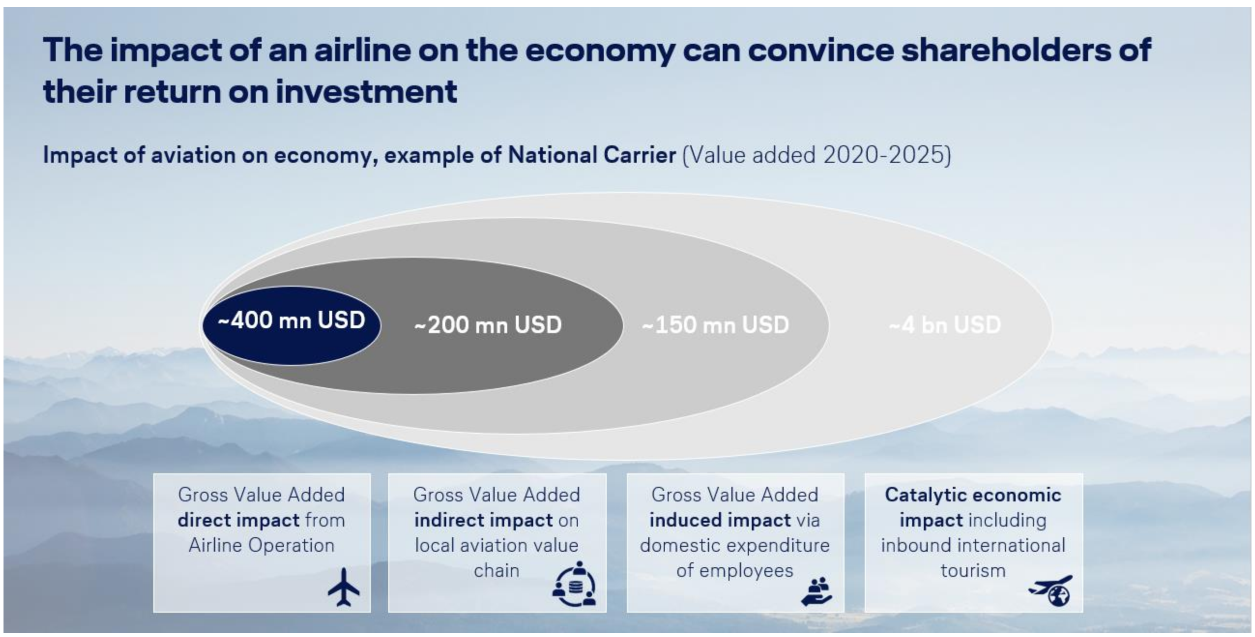
Be Smart: Digitize operations with decision making and steering being based on integrated, AI-supported systems. Even countries with cheap labor should feel the need to invest in digitalization. Digitalization is not necessarily about reducing man power – it is about smart steering. On the revenue side, airlines need to be enabled to effectively predict and match a customer's willingness to pay at any moment in time. On the operational side, airlines have to maximize the utilization of their assets, especially their aircraft.

Be Sustainable: Managers have to convince their stakeholders (investors, governments as well as customers) of their commitment to the future. The airlines will need to present a credible story regarding their commitment to sustainability.

Be Collaborative: African aviation will be stronger if it stands united and works together. Airlines should go beyond code shares and optimize costs with the right network of partners. Kenya Airways and Congo Airways and their strategic MoU cooperation is a successful example of technical and commercial cooperation. Furthermore, African airlines continue to be exploited by OEMs in deals for aircraft that do not really fit their purpose. Why not get help with an independent network plan to identify the airline's specific needs and team up with other airlines with the same needs to increase leverage? Then those alliances can engage experienced negotiators to get the best deal for everyone involved.

Shape the market: Stick together to use the crisis to accelerate African market liberalization. Africa has little to no real LCC traffic, which is partly due to protectionism. This is not viable in the long term and damages the industry as a whole. There is a huge opportunity to accelerate liberalization right now. Finally, implementing the Single African Skies SAATM should be a priority for the market to drive not only the broader goal of connectivity, but also financial strength.

Getting financing from public investors for the future business model requires a convincing story



Having defined the future business model and the transformation path to get there, the next order of business is securing the financing required to proceed with the transformation path. If the airline's strategic purpose is to provide connectivity to its home country, this should also create a positive contribution to the economy. The impact of an airline on the economy can reassure shareholders of their return on investment. The return can be measured, estimated and forecasted by assessing four dimensions:

- **Direct economic impact** due to the airline's operation (wages for airline, airport and ATC workers)
- **Indirect impact** due to the spend on supplier's value chain (primary - airports, ATC; Secondary - travel services, catering)
- **Induced impact** of employees increasing the purchasing power in the region

- **Catalytic impact** as the wider economy benefits due to the facilitation of trade or investments as a result of air connectivity including the tourism impact enabling tourist expenditure by visitors, and the impact it has on the tourism industry

What is the key to become a master of survival in Africa?

The first order of business is to evaluate the future readiness of the airline's business model. Next, depending on the airline's strategic purpose, the ideal future business model and the transformation path to get there are to be defined. The combination of an individual market forecast, the new business model and the corresponding forecasted production levels can then be used to derive the required financing needs. As a last step, in case the airline is trying to convince a public investor, the impact of the new business model on the economy as a whole can be evaluated.

Following those steps, airlines can create a compelling story for potential investors mapping out what the airline needs and what the investors can expect in return. This is the key for African airlines to emerge as masters of survival.

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Watch the presentation by Matthias Kern*: "The future of airline business models for Africa post-Covid" which he held at the African Airlines Association (AFRAA) 9th Aviation Stakeholders Convention: https://www.youtube.com/watch?v=DWEYD3dJuBY&t=23s*

Further insights from Lufthansa Consulting's aviation experts are available at https://www.lhconsulting.com/insights/news/

Contact: *To learn more and discuss how your organization could benefit from Lufthansa Consulting's expertise please get in touch at Matthias.Kern@LHConsulting.com*

[i] Source: https://www.nytimes.com/interactive/2021/world/covid-vaccinations-tracker.html