The AOC Balance

How airlines can derive strategic benefits from multi-AOC operations.

BY LARS-MICHAEL WENDEL AND ARVIND CHANDRASEKHAR

IN JUNE 2019, RYANAIR CEO MICHAEL O'LEARY announced that his airline group would establish a new startup airline in Malta, adding a fourth operator to those in Ireland, Poland and Austria. Later the same month, Lufthansa Group announced it would take strategic actions to boost the turnaround of its LCC carrier, Eurowings, to include consolidating German flight operations into a single air operator certificate (AOC). Although the two players had different reasons for their decisions, their actions indicate the dynamic nature of how airlines manage multiple AOCs, seeking to balance flexibility with standardization.

The global aviation industry is in a constant state of upheaval and strategic evolution as it strives to meet the demand for air travel in a manner that is financially sustainable. One of the most striking developments over the last 15 years has been continued industry consolidation, resulting in the rapid rise of airline groups. Some, such as International Airlines Group (IAG) and the Lufthansa Group, are multi-brand portfolios. Others, like AirAsia Group and Norwegian, operate as a single customer brand. Either way, these airline groups operate on a platform of multiple AOCs.

"A good solution establishes a balance between the complexity of multiple operator certificates and the strategic, financial and market-related benefits of retaining them."

It is interesting to understand why some airlines operate with multiple AOCs and how they have chosen to organize them. Airline managers usually have a range of options, so final decisions must be made after weighing the increased complexity of a multi-AOC strategy against its potential strategic, financial and customer-driven benefits.

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WHAT IS AN AOC?

IATA defines an AOC as simply the "approval granted by the national airworthiness authority to an aircraft operator to allow them to use their aircraft for commercial purposes." Associated with the AOC is the operator's ability to provide the people (crew, regulatory positions), equipment (aircraft and maintenance) and systems (quality management and financial means) required by the relevant regulator to perform commercial transportation by aircraft.

Hence, a set of AOCs within one airline group allows the group to differentially position each production platform. This enables optimizations for labor regulations and collective agreements, fleet ownership structures and operational procedures, for example. An airline group therefore can use different AOCs to execute a composite overall strategy.

AOCs within a single airline often span different countries and, although separate companies in a legal sense, may operate as a single unit from the perspective of strategic planning, network and customer engagement.

WHY MULTIPLE AOCS?

In an ideal world, an airline would have only one AOC in the interests of a simple corporate structure and standardized operations. Continental Airlines and United Airlines, for example, cen-

AOC Spectrum

SOURCE: LUFTHANSA CONSULTING

tralized operations under one AOC in November 2011, about a year after their merger. American Airlines and US Airways took the same route.

However, a multi-AOC situation can come about for a variety of reasons. For some airlines, including Air Nostrum, Philippine Airlines (PAL) and Qantas, this arises from acquisitions or similar legacy developments. In other cases, the move to two or more AOCs is driven by strategic reasons, including cost savings, expansion into new regions or the desire to offer varying value propositions. Singapore Airlines' Scoot, Lufthansa's Eurowings and Cathay Dragon (formerly Dragonair) are key examples of these. Finally, there are decisions driven by legal or regulatory reasons. UK-based LCC easyJet long stated that its decision to file for an AOC in Austria was driven by the need to have a legal presence in Europe to prepare for the UK's exit from the European Union and to ensure continued operations across and within EU countries post-Brexit.

On top of the decision about whether to have more than one AOC comes the branding decision and whether there should be one brand or multiple brands. Here, the desire for market differentiation is generally the primary driver.

In Lufthansa Consulting's experience advising airlines globally, airlines employ a spectrum of strategic options when managing their AOCs. These are generally driven by the purpose of acquiring or establishing the AOC to begin with, ranging from operational efficiency to market positioning. In effect, this spectrum moves from a high level of brand and operational integration on the left, to highly distinct brands and market definitions on the right.

Let's consider three specific and distinct examples.

To increase its share in its home market, the Philippines' Cebu Pacific Air completed the acquisition of Tigerair Philippines in January 2014. After operating under the Tigerair Philippines brand for more than a year, Cebu Pacific rebranded its new AOC as CebGo in an attempt to further streamline operations and positioned it as a full-turboprop operator in May 2015. CebGo operates its aircraft in Cebu Pacific livery and is therefore a perfect example of the left end of the spectrum. To the customer, the airline presents a single brand and service proposition. Only a small note "operated by CebGo, Inc." and placed on the aircraft and in the booking system, as well as the IATA code DG, indicates that a particular flight is operated under the CebGo AOC. All commercial and operational planning for the subsidiary is performed by Cebu Pacific under the mother brand, which is also leveraged for all marketing and branding purposes. This enables Cebu Pacific to fully exploit the cost benefits of the former Tigerair Philippines' AOC, centralize competencies for the turboprop operations, and streamline its overall organizational set-up by avoiding separate commercial departments at each AOC.

At the other end of the spectrum, IAG has established a different structure for its multiple AOCs, which partly operate under individual brands, either serving different geographies as full-service network carriers (British Airways, Aer Lingus, Iberia) or operating as pan-European LCCs (Spain-based Vueling). Besides this portfolio of airline brands, there are other AOCs in IAG's portfolio that are used as discrete production platforms. The AOCs of retired brands OpenSkies, based in Paris, Anisec Luftfahrt, based in Vienna, and Iberia are used as platforms to operate flights for Level, IAG's long-haul LCC, which was set up as a virtual airline without its own AOC. While each individual airline in IAG's portfolio could be considered to hold different positions along the spectrum, the group portfolio serves as a strong example of an effective steering of AOCs that balances the degree of centralization and independence needed between them.

Finally, the setup of Qantas and QantasLink is an example from the middle of the spectrum. QantasLink was established in 2002 as an umbrella brand for a number of Qantas subsidiaries operating regional flights. Today, QantasLink features three subsidiaries: Airlink, which operates Boeing 717 services as a franchise under Cobham Aviation Services' AOC; Eastern Australia Airlines; and Sunstate Airlines.

What makes this structure a good example? With QantasLink, the Australian airline can build its core brand (all flights are operated under the QF IATA-code) and network reach, while centralizing the commercial planning and leveraging the lower-cost platforms of the subsidiaries. It also allows differentiation of services between Qantas-operated domestic routes—Qantas operates more than 70 aircraft under its own AOC on domestic services—and the QantasLink regional services without diluting the core Qantas brand (for example, the latter does not offer complimentary alcoholic beverages).

MANAGING A MULTI-AOC

The decision on which path to follow, including whether to establish a new AOC at all and/or how best to leverage existing ones, is not easy. There is no universally applicable "best" solution. It depends on the specific strategic and operational circumstances of the airline under consideration. A good solution establishes a balance between the complexity of multiple AOCs and the strategic, financial and market-related benefits of retaining them.

In general, airline managers should consider four key dimensions, including but not limited to: strategic and corporate structure; brand and product; steering and performance management; and operations and people. (*See chart*)

Occasionally, airlines may choose to change their strategies in response to these considerations. In late 2016, Philippine Airlines chose to move its lower-cost AOC, branded PAL Express at that time, into the unified full-service brand. On the other hand, Qantas launched Jetstar in 2003 based on the acquired Impulse Airlines AOC as a dedicated Australian LCC. Ryanair, long a proponent of a single brand across all its operations, has chosen to retain the LaudaMotion brand for operations in Austria and Germany after acquiring it in 2018, and rebranded its Polish ultra-LCC subsidiary Buzz in 2019. Ryanair is also establishing a new startup airline, Malta Air, in cooperation with the Maltese government, that has its own brand and AOC and will start operations this summer.

Key Dimensions

Strategy and corporate structure	• Platform strategy relevant to market dynamics, regulatory requirements and operational considerations • Number of AOCs and place of jurisdiction • Coherent definition of the mid to long term growth and investment plan for each AOC • Relationship between the AOCs translated to the corporate structure of the airline (or group)
Brand and product	• Brand (and product) strategy relevant to the market dynamics
Steering and performance management	• Effective steering of multiple AOCs, especially if under a single brand • Optimal centralization vs. devolution of decision making • Metrics to track AOC performance, and fair basis for comparison
Operations and people	• Consistent delivery of product and customer experience across AOCs, if required • Harmonization of operations, to be as lean as possible • Appropriate model for employee engagement and communication, across cultures and operating models

SOURCE: LUFTHANSA CONSULTING

THE FUTURE

The establishment of new carriers, coupled with continued merger and acquisition activities, will result in a growing number of multi-AOC airline groups. This is particularly true in Asia and Africa, which are likely to follow the path of the more mature European and North American markets, specifically as regional single aviation markets emerge.

This will raise three key strategic considerations for airline executives and decision makers, beyond the operational elements mentioned earlier. The fundamental requirement will be for an unambiguous and transparent rationale for a multi-AOC operation, identifying the bare minimum platform(s) for sustainable growth versus the "good to have." Coupled with that, the airline must clearly articulate a long-term plan for each AOC, especially if operating under a single brand. Finally, the airline must remain ever aware of the tipping point, when the regulatory and administrative overhead of managing multiple AOCs outweighs the benefits of retaining them.

It is a given that the number of airline groups with multiple AOCs will continue to grow. Their financial success will depend heavily on drawing the best possible productivity, flexibility and efficiency gains from across all their AOCs. ATW

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