# The role of regional airlines in supporting post-COVID-19 industry recovery

*COVID-19 has hit regional airlines hard, with several having ceased operations or gone bankrupt. However, their fleet and business model - deploying small aircraft within a geographic niche - is still highly relevant as the industry slowly recovers. Surviving the crisis will require a willingness among stakeholders in the regional airline business to explore three key avenues: state support, partnership or collaboration models and, in some cases, possible consolidation.*

July 6, 2020

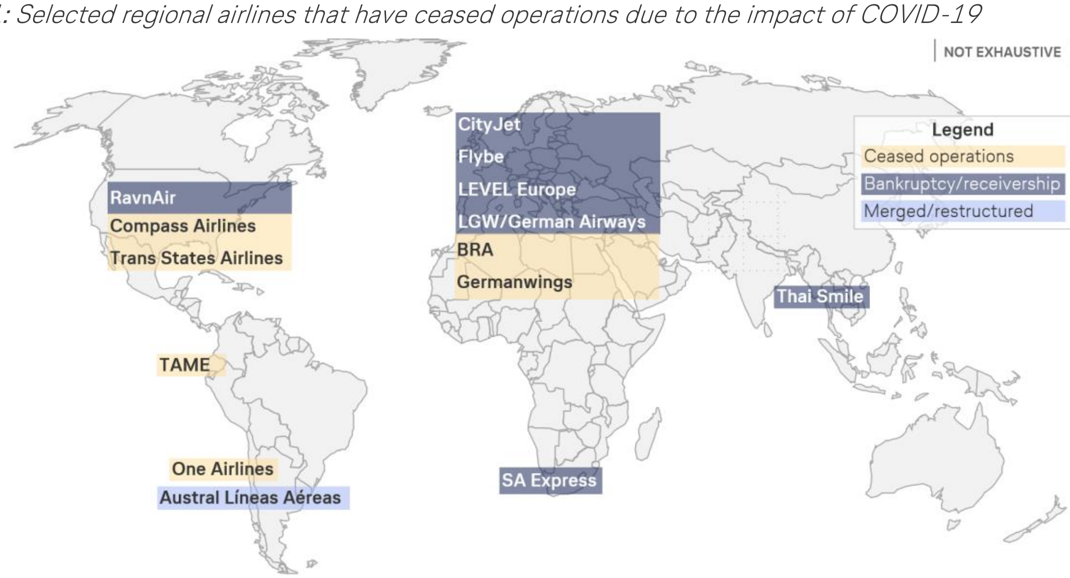
By Michelle Feil and Arvind Chandrasekhar

Regional airlines are undoubtedly an important component of the aviation system. They fulfil an essential part of air connectivity, often operating routes with limited demand or connecting small communities by deploying turboprops, regional jets or, in some cases, narrow body aircraft.

Regional airlines typically operate under one of three models. They may be **affiliate airlines**, owned by and/or operating solely on behalf of a major airline and contracted to take over secondary routes or off-peak frequencies to primary markets (for example, United Express and Lufthansa Cityline). Regional airlines could also operate as **third party capacity providers** (such as SkyWest and CityJet), providing larger airlines a flexible means of expanding or strengthening their networks, usually at lower cost. The final model is that of **independent carriers** (such as Bangkok Airways, Widerøe and Porter Airlines) operating in niche markets with a distinct customer proposition independent of other airlines.

## COVID-19 poses a significant risk to regional airlines in the immediate term

*Figure 1: Selected regional airlines that have ceased operations due to the impact of COVID-19*




*Source: ch-aviation, FlightGlobal, Lufthansa Consulting*
*Note: Reflects situation as of 22 June 2020*

Regional airlines around the world have been buffeted by a series of developments arising from the ongoing pandemic. While a small aircraft allows regional carriers to operate a diverse portfolio of smaller routes, the shorter average trip length and lower seat counts generally result in high unit costs per seat. Operational costs, therefore, are an area of concern at most times. In addition, regional airlines are typically smaller in their scale of business than mainline operators, making it more difficult for them to sustain themselves through a prolonged crisis.

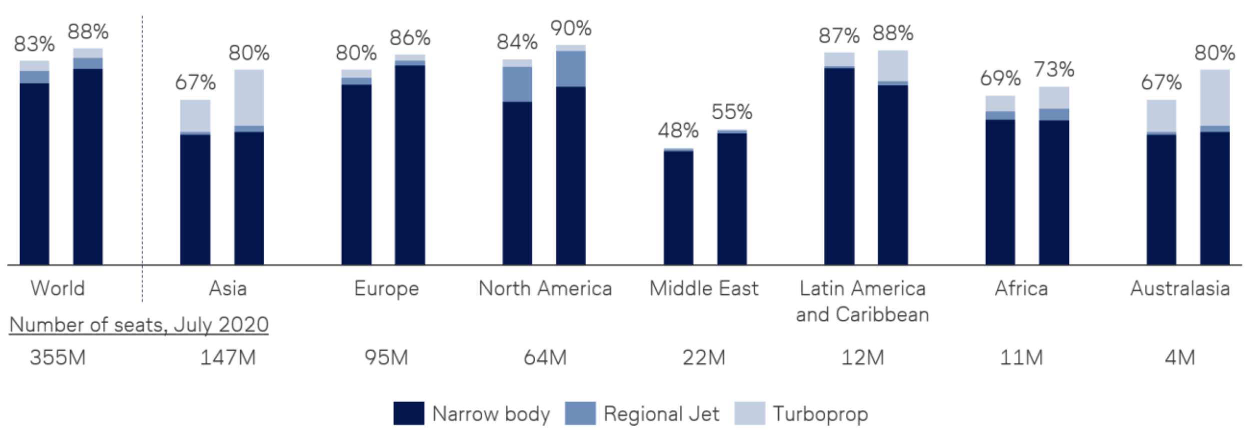
COVID-19 has also resulted in a crash in passenger revenues. Business travel – a key driver for many operators serving small business communities and facilities – is likely to be particularly strongly hit in the near to mid-term.

The situation is particularly dire for capacity providers, as several large airlines have shrunk their networks and have chosen to cancel their contracts. The recent bankruptcies in Europe of CityJet and German Airways illustrate the fragility of capacity providers reliant on a few large contracts.

**However, the regional airline fleet and business model is highly relevant as the industry recovers**

As capacity slowly returns to the skies, airlines have skewed towards deploying smaller aircraft. This is a prudent approach given the uncertain and depressed demand profile of most markets. In July 2020, for example, regional aircraft account for 88% of scheduled seats as compared to 83% in the same month last year. The difference is even more stark in certain regions such as Asia, Latin America, Africa and Australasia where the share of turboprop aircraft, in particular, has risen sharply.

*Figure 2: Share of total scheduled seat capacity operated by aircraft other than widebodies, July 2019 (left bar) vs July 2020 (right bar)*




*Source: IATA SRS Analyser, Lufthansa Consulting*
*Note: Aircraft types and regions are as defined by IATA. Reflects schedules as of 22 June 2020*

In fact, several large airlines are quite aggressively drawing down their fleet of widebodies in favor of a focus on narrow bodies or regional jets. For instance, Air France and Lufthansa have retired some or all of their A380 fleet ahead of schedule. Delta has hastened the retirement of its MD-88, MD-90 and Boeing 777 fleet, as has Qantas with its Boeing 747 aircraft.

This is driven by the recognition of certain key truths

- Volumes will be depressed for some time to come, even on routes that could earlier support large narrow body or wide body aircraft
- Fleet deployment will need to ensure high load factors in order to build operations without burning cash and spiraling into further liquidity traps
- This would need to be achieved alongside a stringent focus on costs to fly with the most cost-efficient operating platform(s)

Ensuring an airline and its fleet is “right-sized”, therefore, is now more important than ever as the industry begins its slow climb back to pre-crisis passenger volumes.

**Regional airlines, therefore, have a vital role to play in the future…**

With their fleet of optimally-sized aircraft, regional airlines are well placed to offer the right capacity in the right markets, serving the rebound of travel demand while lowering the risk of overcapacity. This is particularly true when serving smaller routes that often have healthy demand and deliver strong financial returns if served with the right aircraft and product.

In addition, regional airlines are, and will continue to be, critical providers of connectivity to remote and island communities in a manner that larger operators will not be able to replicate. This is an essential socio-economic role that needs to be protected.

**…but only if they survive**

As we have seen, many regional airlines are fighting an existential battle at the moment. Apart from internal measures (right-sizing operations and organizations, renegotiating provider contracts and improving processes), this requires concerted support from external stakeholders – governments, airports and other airlines.

There are three key avenues for regional airlines to survive and thrive. These are not mutually exclusive choices; instead, an airline must pursue all of them to build a stable basis for the future.

- **Work closely with governments and regional airports** to ensure sustained service. Governments, in particular, should consider leveraging their mobility and transportation budgets to expand Public Service Obligation (PSO) programs as well as offer one-off loan guarantees and liquidity support measures. Some countries such as the USA have acted quickly to provide financial support but many others, particularly across Latin America, Africa and Asia, may need to do more in the interest of maintaining their aviation ecosystems.
- **Build collaborations with larger airlines** as the large operators seek to rebuild their networks in a sustainable manner. This could take the form of commercial partnerships, in the case of independent regional airlines, or continued outsourcing to affiliates and capacity providers. These opportunities could return – or even increase as compared to pre-COVID times – if regional carriers can continue to establish their cost advantage while bringing in highly-needed revenue to larger airlines. While all airlines are pressed for liquidity at the moment, putting in place commitments for a long-term partnership is important. For the regional carrier, this provides a perspective for the future and ensures backing to discuss its prospects with creditors and investors. For the larger airlines it provides a pathway to a more sustainable ‘own

fleet' size and cost position to navigate the post-crisis environment. The key here is a willingness to explore "win-win" collaborations of mutual benefit.

- **Seek opportunities for consolidation**. This can be a merger or acquisition involving two regional airlines, or the consolidation of a regional airline 'upstream' with a larger airline. The economies of scale and optimized deployment of the most relevant fleet and operating platform could help them survive and continue to participate in the recovery of the industry. For example, the Government of Argentina has announced that it will merge the flag carrier Aerolíneas Argentinas with its regional airline subsidiary Austral Líneas Aéreas in order to improve efficiencies and reduce costs.

Regional airlines fulfil a critical and distinct business role in the aviation industry, but the COVID-19 pandemic has put them at significant risk. It is essential that they, together with industry stakeholders, identify the most optimal path to survival, be that Government support, partnership, consolidation or a combination of these measures. That would ensure more efficient networks, stronger commercial performance and more sustainable operations for the industry as a whole, carrying all parties involved through the crisis.

*To learn more and discuss how your organization could benefit from Lufthansa Consulting's expertise on Airline Strategy and Crisis Recovery, please get in touch at ALcrisis-solutions@LHConsulting.com.*

---

*Arvind Chandrasekhar is an Associate Partner, and leads the Solution Group Network and Fleet Management at Lufthansa Consulting. Michelle Feil is an expert in the Solution Group.*

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

---