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Departures

Opinions On Current Issues In Aviation

Removing ASMs From The Trash Can

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Imagine that an automobile manufacturer routinely scrapped one out of every four cars it produced. How successful would that company be?

It may sound crazy, but that's what the airline industry has been doing since the Wright Brothers. If an airline runs a 75% load factor, then 25% of its productive capacity ends up in the trash can, and the cost of that production becomes a deadweight loss.

It's not that cost problems have gone unnoticed. Over the past decade, the airline industry has made great strides in reducing its operating costs, and to a large extent, these efforts have paid off. Most carriers have succeeded in reducing cost per ASM in a variety of ways, including obtaining labor concessions, renegotiating more favorable terms on leases and facilities, and charging for services that were formerly free.

> *'Revenue management techniques have reached the limit of what they can accomplish'*

But the progress in reducing costs has not been followed by an increase in profitability. In fact, the industry has suffered large cumulative net losses since 2001. One of the key reasons for this is that the cost-cutting initiatives have ignored a major source of excess cost: unsold seats.

Of course, it is not easy to go after the cost of unsold seats because the industry's normal scheduling method is to set a fixed capacity level to accommodate the average peak travel day, based on long-range forecasts. Revenue management techniques are then used to forecast high-fare business traffic, set aside seats for them, and make the remaining seats available to price-sensitive travelers. Sometimes, fares are deeply discounted on low-demand days, on the theory that any incremental revenue is better than no revenue at all.

For this and other reasons, revenue management techniques have reached the limit of what they can accomplish. An approach that can go further is to use supply chain techniques already common in the manufacturing industry to vary capacity day by day and market by market according to demand. When demand is high, airlines could produce more capacity in the markets where it's needed, either in the form of additional flights or larger aircraft. When demand is low, offering lower capacity to the marketplace is a more effective way to reduce costs than discounting ticket prices to a ruinous level just to fill seats.

Supply chain techniques can be implemented without alienating the consumer with unwanted departure time changes or by canceling low-load flights. Airlines can start with a slightly smaller schedule and have a small bit of capacity left unscheduled, which can then be inserted into the markets that have need for additional lift, based on the passengers that have already booked in those markets. This will increase revenue, while simultaneously offering the customer more choices. From the customer's perspective, nothing has changed, but from the airline's perspective, they're now producing an ASM mix that is much better aligned with what the marketplace is asking for.

Implementing these supply chain techniques can free airlines from being "at the mercy of their dumbest competitor" (as former American Chairman Bob Crandall used to say), whereby anytime an airline offers a ridiculously low price, its competitors have the choice of matching fares and losing money or not matching and losing even more money. In a flexible scheduling environment, there is the additional option of holding capacity at a low level, which not only limits the damage inflicted by the market having the price war, but also releases capacity that may have more profitable uses elsewhere.

Instead of making seats people don't want to buy and then facing the choice of selling them at a loss or throwing them away, it's time to embrace supply chain techniques to produce the ASMs that people really do want. That has to be a better alternative than another year of nine-figure losses from fixed, inflexible schedules that don't serve anyone's real needs.

Ira Gershkoff is Founder and CEO of JIT Airline Resources, a company that offers software and services to enable airlines to vary schedules according to day-to-day demand. For more information, go to www.jitairlines.com.