Air cargo

Too little freight, too much space

http://www.economist.com/news/business/21695013-overcapacity-hits-another-part-transport-industry-too-little-freight-too-much-space

Overcapacity hits another part of the transport industry
The Economist. Page 58, March 19th 2016.

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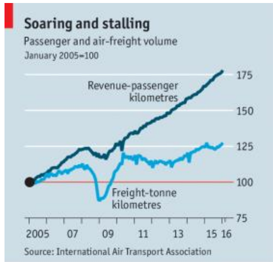
Although East Midlands airport is bustling, and the global air-cargo business now handles more than a third of world trade by value, the industry has been under pressure since the financial crisis. At the World Cargo Symposium, a meeting of industry bigwigs in Berlin this week, there were grumbles that their business has seen better days. The volume of goods travelling by air has risen marginally over the past year but airlines' cargo revenues have fallen from a peak of $67 billion in 2011 to around $50 billion a year now. Freight provides just 9% of total airline revenues now, down from over 12% a decade ago.



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Commented [KEQ1]: **Definition of industry: (PDF Page 83)**
[Industry segmentation (PDF Page 90)]
If you define your analysis as 'Global freight business' you include both air and sea freight. This is very broad and will lead to a less detailed and accurate analysis.

Within this 'global industry' is the 'air-freight' market, which can be defined as an industry in its own right.

If you are an organisation in this industry, and you wish to conduct strategic analysis – you could even choose to make it more narrow than this. For example, if you only compete in particular geographic regions, you may narrow the industry to a particular set of locations, rather than analysing it globally.

The key rule: Choose the definition of industry that gives the most useful analysis for the organisation under investigation.

Commented [KEQ2]: **Industry life cycle: (PDF Page 94)**

Physical volume of freight is growing, but not by much.

More concerning is that despite the same amount of physical movement, the revenue generated is declining (Dropped $17 billion in 5 years).

So – what stage of the industry life cycle would this be? (Check out Figure 2.10).

Commented [KEQ3]: Definition of industry again…
Some organisations are purely 'freight' based.

Others also provide passenger services, so freight is just one component of their business.

For this type of organisation – the definition of industry could be different again. Freight, at less than 10% of revenues, may be seen as a distraction to be avoided – which is demonstrated later in this article when British Airways stopped doing pure freight flights.

(Check out the Strategic Management Accounting Case Study Module for more detail of this perspective…
In this situation the industry being analysed is the Australian Domestic Airline Industry.
It is split into 4 segments:
Business travel: $8.2 billion revenues
Leisure travel: $4.9 billion revenues
Freight: $1.1 billion revenues
Other: $0.8 billion revenues.

A dramatic fall in sea-freight rates—of more than 75% since 2012 on some routes—as a result of **overcapacity among shipping lines** has **encouraged customers to switch** from sending some non-urgent deliveries by air.

Commented [KEQ4]: Remote and industry environment analysis (PDF Page 96)
Specifically: 5 Forces analysis: Power of substitutes (PDF Page 118)
Cross-price elasticity of demand
- The sensitivity of sales in relation to changes in prices of substitutes or complements.

Although the study guide doesn't go into detail about elasticity – it refers to the effects on demand for things like changing prices. For example, lower prices usually leads to higher demand (price elasticity of demand).

In this air-freight situation – even if you keep your price the same, and the service levels the same – you are still going to see a drop in demand. This is because your substitute – sea-freight, is 75% cheaper than it was 3 years ago. So, this is a compelling reason for a customer to shift to a different delivery channel. High power of substitutes is going to hurt your profitability, as prices may need to drop to stay competitive (we saw that with the $17 billion drop in revenue despite the slight increase in physical volumes).

This shows how our analysis flushes out the reasons/causes for change and problems. This in turn sets the scene for us choosing new strategies to help survive and thrive.

Excess capacity among the airlines themselves has done further damage. Since the financial crisis, there has been no let-up in the growth of passenger demand, so carriers have been expanding their fleets. This means the amount of cargo space in the belly of passenger planes has risen sharply. Combined with flat demand for shipping by air, the result is that **average capacity utilisation across the air-cargo business has fallen to 43.5%,** the lowest since the crisis. So, customers have been able to demand big price cuts.

Commented [KEQ5]: **5 Forces analysis: Intensity of industry rivalry (PDF Page 121)**

Capacity is listed as an important dot point linked to intensity of rivalry. If there is too much capacity – people will compete very hard (with lower prices) to fill that capacity – because some revenue is better than nothing. Greater intensity of rivalry is going to also hurt profits.

Some all-cargo airlines have gone bust in recent years, and other carriers with big cargo divisions have been suffering, despite the fall in the cost of jet fuel. Last August, for instance, Midex, at one point the largest all-cargo airline in the Middle East with a ten-strong fleet of freighters, closed down. Lufthansa Cargo, the freight division of Germany's largest airline, slipped into loss last summer. South America's largest airline, LATAM, reported a 27% year-on-year fall in cargo revenue for the fourth quarter of 2015. LATAM has responded by cutting its use of freighter planes to focus on belly-hold cargo. IAG, the **owner of British Airways, now looks prescient for having got rid of its freighter fleet altogether.**

Commented [KEQ6]: Industry life cycle again…Potential shake-out (PDF Page 95) as competitors exit the market?

Exports from Africa to Europe and mainland China to America are more significant than passenger flows between them. Long journey times across the Pacific mean that many passenger aircraft do not have the range to take off with a full hold. Even so, airlines operating freighters are being **squeezed into such niches** by the expansion of integrated logistics businesses such as DHL, FedEx and UPS. These firms, with their vast fleets of planes, lorries and vans, and their highly efficient distribution centres, are sucking up much of the business from e-commerce companies. FedEx said this week that net profits in its most recent quarter were up 18% year-on-year, beating expectations.

Commented [KEQ7]: Porter's generic strategies: Focus (Table 3.4) (PDG Page 191)
-Narrow geographic segment: Concentrating on a narrow geographic area, rather than the global industry.

Is this a potential strategic solution? Choose a focus strategy?
What if all the other competitors try and do the same thing? It will become a red ocean pretty quickly.

Commented [KEQ8]: Industry Value chain (PDF Page 84)
Integrated – Here we organisations who operate in several parts of the chain. Instead of just providing air-freight, they also provide the pick up from the customer, road / train transport to the airport, the air-freight, then delivery to the customer.
Levels of integration is linked to analysis of buyer power and supplier power (5 Forces).

Vertical integration (PDF page 268)
Potential strategy to move around in the value chain to gain more power, capture more margin, and compete more effectively. Exposes you to risks if you do not have the different types of capabilities **(page 205)** required to operate in each value chain segment.

Commented [KEQ9]: Competitor analysis (PDF Page 135) and industry rivalry (PDF Page 121)

You need to be able to do a detailed assessment and analysis of what your competitors are going to do. Not just the other airlines who provide freight services, but integrated logistics businesses. Another major threat.
This can potentially be considered under 'Threat of new entrants (5 Forces)' as well, although they are already in the industry.

Even the logistics giants may soon see their businesses disrupted. This month Amazon, an e-commerce giant, said it would lease 20 Boeing 767 jets for its delivery service. That should have caused some concern at DHL, which currently makes a quarter of its revenues from shipping Amazon's packages. Though planemakers continue to enjoy strong demand for passenger aircraft, weak sales of cargo planes are forcing them to re-examine their freighter programmes. Airbus has put on hold its plan to launch a freighter version of its A380 superjumbo. Sales of the latest freighter version of Boeing's jumbo, the 747-8F, have disappointed since it entered service in 2011. Analysts used to think there was a case for a further update to the 747 freighter, to replace planes that will be retired in the 2020s—but now there is much scepticism.

Commented [KEQ10]: 5 Forces analysis: Threat of new entrants (Page 114)
Amazon are known for focusing on market share not profits, which means lower prices and a tough competitive environment.

Also value chain analysis & integration (page 116):
DHL has a customer (Amazon) that is now going to do the work themselves. Not only do they lose 25% of their revenues, they also face a serious competitor who may steal even more revenue away.