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## "IF CONSOLIDATION OCCURS, IT WOULD DRAMATICALLY REVERSE DECADES OF HISTORY"

**A**re we in the midst of a trend towards industry consolidation? Consolidation has been the hot topic in aviation for several years, with many forecasting an inevitable wave of mergers.

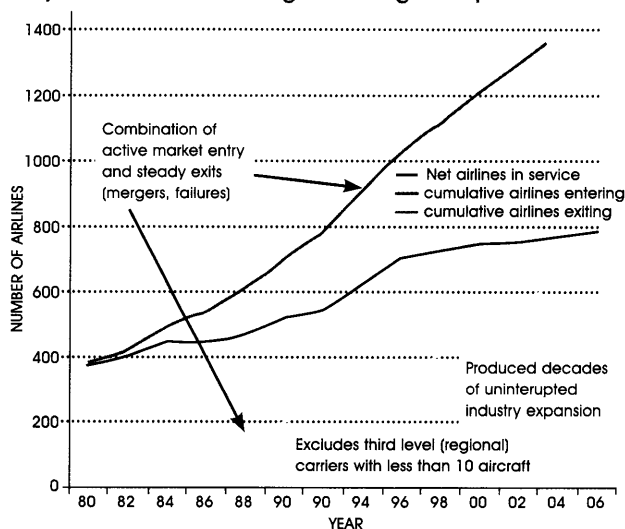
"Industry consolidation" means changing the structure of the industry. A given level of global capacity would be served by fewer and bigger carriers. But this has never occurred in commercial aviation. If it occurs in the future it would dramatically reverse decades of history in which the industry has continuously become less consolidated.

In 1980, excluding third-level (commuter) carriers with fewer than 10 aircraft, 379 commercial airlines companies were operating worldwide. Over the next 36 years, 1,123 companies entered the market and 722 left through either mergers or liquidations. By 2006 the number of airlines operating had more than doubled to 780.

Growth in the number of airlines slowed during each economic downturn but the overall number has never fallen. Depending on the depth of the looming recession, we may see our first exception.

This historic pattern reflects the "dynamic churn" of a healthy, growing industry. Passenger traffic and investment capital has been continuously moving from weaker carriers to stronger ones.

### Dynamic churn drives growth of global pax airlines



Existing carriers learned from the better start-ups, and avoided the mistakes of the others. Mergers and bankruptcies actually reduced consolidation by accelerating the innovation and capital productivity that is critical to any industry's growth.

Why do people associate mergers and consolidation with a shrinking industry when that's never happened? One reason is that media coverage of isolated high-profile mergers obscures the vibrant longer-term growth picture. It is not surprising that investment bankers might extol the virtues of specific transactions, but that doesn't create an industry-wide trend.

There is also a common misconception that industries have a "natural lifecycle", with boom followed by shakeout/maturity and then major consolidation. This is true of many narrow sectors that can be supplanted by new technologies or business models, but aviation isn't mature, and it certainly isn't becoming obsolete. Air travel demand remains enormously robust in the face of all but the most dramatic of economic downturns.

Industry-wide consolidation would occur as the result of stagnant productivity and declining demand. These could be triggered by unanticipated external changes, such as the combination of permanently high fuel prices, dramatically increased taxation and new governmental obstacles to market competition. None of those are a natural consequence of airline history, and none make consolidation inevitable.

Aviation's growth has always been driven by innovation. A structural shift to fewer/bigger airlines won't solve the industry's woes. Instead we must reduce protection for the less-efficient and dismantle barriers to capital mobility (for example obsolete ownership and control rules and artificial barriers to exit). The resulting mergers, restructurings and "dynamic churn" – as history has shown – should reduce concentration while maximising growth.

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