

Newsletter

Executive Search *Aeronautics, Aerospace*

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Best wishes for 2014.

The aviation industry is growing rapidly; this growth is mainly driven by airlines in emerging countries and by a strong demand for more fuel-efficient aircraft. Manufacturers and their suppliers must ensure their supply chain is able to meet the growing demand and the development of new generation aircraft.

Happy reading!

Tanguy de BOISANGER



The aviation sector - a phase of fast growth.

I. OVERVIEW OF THE MARKET

In the wake of the global economic crisis, that stabilized production levels since 2007, the aviation industry has been growing again since 2011. The industry benefits from positive structural factors, most importantly **the development of emerging economies and new constraints regarding fuel consumption** (with the introduction of CO2 allowances in 2012, and soaring oil prices) that feed the need for fleet renewal.

In the civilian sector, the democratization of air travel with the opening of new routes and the development of world tourism lead to an increase in the number of passengers transported by air, with a positive impact on orders for new aircraft.

For the military market, the industry will benefit from **increased defense spending in several emerging countries**, but must deal with the **planned reduction of the U.S. defense budget**. This will have an impact on the strategy of U.S. industry groups (such as Lockheed Martin and Northrop Grumman) which may focus more on export.

The competitive landscape will also undergo gradual changes. Manufacturers from Canada (Bombardier) and Brazil (Embraer), already established in several niches, but also groups from Japan (Mitsubishi and Kawasaki), Russia (UAC), and China (Comac) will eventually enter the medium-haul segment, occupied by Boeing and Airbus since 1997. But this **new competition** also provides new opportunities for existing operators. Manufacturers (mainly Boeing and Airbus) will thus be able to form new partnerships for

development, while the component and engine manufacturers (General Electric, L3 Communications, Thales, UTC, Safran, Honeywell, Rolls-Royce, Raytheon) will diversify their customers.

II. SIGNIFICANT GROWTH PROSPECTS

The year 2012 saw a 14% increase in aircraft delivered, together with a redefinition of business models through alliance (Qatar Airways joins oneworld, the third airline alliance, on October 30, 2013) or partnerships (Etihad Airways with Air France-KLM in October 2012). The year 2013 should see a further 10%¹ increase in deliveries and mark the beginning of a **global consolidation of air transport**. This consolidation is generated by an **increase in manufacturers' production rates**, expecting rapid growth over the next twenty years. Indeed, Airbus and Boeing anticipate an **air traffic growth** of respectively **4,7%² and 5%³** per year (passenger and cargo) **between 2013 and 2032**, a cumulative air traffic growth of over 250%.

Among the major growth factors, **demographics** will play a leading role, with an increase in passenger numbers from 2.9 to 6.7 billion, mainly due to the **expansion of the middle classes** whose share in world population will increase from 32 to 62% over the next two decades. The **number of megacities** will also increase from 42 to 89 over the same period, fueling the **demand for jumbo jets**; jumbo jets will then account for nearly 59% of the value produced by the aviation industry.

These major developments contribute to shifting the center of gravity to **emerging markets**, where **two-thirds of the world's**

future economic growth will happen, and that should benefit from market liberalization in Asia, Africa and Latin America. Meanwhile, the economic model of low-cost operators should also expand in Asia/Pacific and Africa, and impact favorably the sales growth of single-aisle aircraft (69% of units sold by 2032).

Thus, air fleets should double their size in number of aircraft by 2032 (for a total of 35 to 40 000 new aircraft, worth more than \$4,500 billion). 60% is due to **demand growth** as mentioned above. The remaining 40% increase stems from the need to replace two thirds of existing aircraft, in part because of the aging of the fleet, but mostly because of new environmental legislation, reducing both greenhouse gas effect emissions and industry profits' dependence on fuel prices.

III. RISKS AND CHALLENGES

The coming changes will have a major impact on the business strategies of the current players in the field. Initially it will be about **new entrants**, since despite high barriers to entry due to the importance of initial investment and technical complexity (which delayed even relocations despite lower labor costs), emerging countries are also seeking to **develop national champions**. Comac (China), UAC (Russia) and Hindustan Aeronautics (India) should compete with European and American champions Airbus and Boeing on their 2020 jumbo jet contracts, particularly since buying governments impose **technology transfers** to local businesses.

Intra-industry rivalry, already tense because of the Airbus-Boeing duel and the oligopolistic structure of the market, will be further reinforced. This is partially due to the strategic and political issues related to the industry, which bring a strong **state interference** accompanied by **protectionism** (even more after the adoption of the European

environmental tax, on hold for now until March 2014 for intercontinental flights). The **ongoing technological confrontation** (the success of next-generation aircraft being directly linked to their technical performance) also plays a role.

The influence of **alternatives to aircraft** remains limited on long hauls but is felt more on short distances, where the **development of high-speed trains** directly threatens flights shorter than 400 km. In the military sector, **drones** share is growing on a market dominated so far by the US and Israel.

Regarding **suppliers**, aircraft manufacturers are and will remain highly concentrated, which always puts them in a **position of power** and also allows them to have **OEMs shoulder a portion of R & D expenses**. However the increase in the number of players should promote **customer diversification** (therefore revenue diversification) for the OEMs, thus enhancing their own financial health and resilience. The **relationship with engine manufacturers remains more balanced**, engines being essential for the aircraft manufacturer.

Finally, the strong bargaining power with customers will last for manufacturers who continue to benefit from their central role in the supply chain. However, civilian airlines current financial difficulties lead to a horizontal integration of carriers, that could somewhat correct the balance of power. In the military market, the players remain dependent on their national state, which could slow Airbus and Boeing (due to the decline in military orders related to the recession in the EU and the U.S.), while companies located in emerging countries would end up strengthened.

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Career path in the SNECMA group, now SAFRAN, most recently Chairman and CEO of Messier-Dowty. Before, he had been successively General Manager of the Gennevilliers production plant (1994-1997), General Manager of the military engines division of Snecma Engines (1998-2002), President and CEO of Hispano-Suiza (2002-2007). He had also taught at the National School of Aeronautics and Space (1980-1986).

Pascal has many published articles in the field of behavior laws and damage to materials.

A former student of the Ecole Polytechnique, Pascal holds an Engineering degree from the National School of Aeronautics and Space.

Other interests include painting, boats, classical music and travel, and collecting paintings by contemporary artists. Pascal also practices running, skiing, and water skiing.

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Recrutement de cadres

Sources

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- 1 Euler Hermes, *Analyse sectorielle aéronautique*, 13/12/2012.
- 2 Airbus, *Global Market Forecast 2013-2032*, booklet p.14, slides p.13.
- 3 Boeing, *Current Market Outlook 2013-2032*, pp.3 et 14.