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Why Airlines Need A New Aircraft Purchasing Strategy

By Tim Hoyland and Seth Ross, Oliver Wyman

Many airlines are poised to replace their older aircraft with newer, more efficient models. Innovations like the geared turbofan from Pratt & Whitney and the CFMI's LEAP-X engine, for instance, promise significant fuel burn benefits. But much has changed in the airline industry. To make the best fleet decisions in this environment, carriers will need to adjust their purchasing strategy.

Many airlines believe that they incorporate the total cost of ownership (TCO) into their purchase decisions. In practice, however, they tend to focus on a handful of relatively easy-to-calculate metrics, such as purchase or lease price, standard fuel burn and OEM-reported direct maintenance costs. While critical, these measures don't reveal the whole story. Failing to account for all the lifecycle costs of an aircraft can be an expensive oversight.

Airlines have the most leverage at the point of purchase—when the aircraft and component OEMs are eager to make a sale. In fact, we think of OEMs like Gillette, which famously sold razors at a low price in order to lock in the lucrative blade market. Airlines that buy an aircraft without negotiating the cost of the "blades"—maintenance—will likely pay more in the long run as the fleets age and costly repairs are needed.

To develop a more accurate TCO estimate, airlines need to source engine, airframe and component maintenance while making their aircraft purchase decisions. That will enable them to compare actual expected costs, not just "marketing" projections, at a granular level. More importantly, it gives carriers the power to negotiate each risk and cost separately.

Once, airlines could afford to wait until maintenance events arose to negotiate service and maintenance contracts. Carriers could rely on high-tech parts manufacturer approvals (PMAs), repairs, surplus spare parts and less expensive alternatives to OEM components. But in recent years, OEMs have made a series of strategic moves to protect and grow their share of the aftermarket. Consolidation in the industry has created a new class of "Super-suppliers"—large, integrated OEMs that have been able to manage their intellectual property in the aftermarket, reducing the real impact of PMAs, especially on high-tech components and non-book repairs.

In a 2010 Oliver Wyman survey, we found that few independent MRO shops wanted to truly take on the OEMs beyond a certain level of repairs. Fifty-seven percent of MROs and half of OEMs surveyed saw their counterparts as either customers or partners, not competitors. With license agreements and more cooperation, OEMs have inserted themselves between airlines and MROs.

Specifically, when negotiating service agreements for new aircraft, airlines should focus on four areas that can drive maintenance costs: the warranty period; complete and discounted pricing catalogs; material cost escalation; and service bulletins, technical upgrades and/or airworthiness directive changes. These factors together can easily make the difference between the right aircraft and one that adds unnecessary risk to the bottom line.

This approach complicates the aircraft purchase process, since the airline must essentially conduct an aircraft RFP simultaneously with an airframe maintenance RFP, an engine RFP, and multiple component RFPs. The alternative, however, hands over long-term cost control to OEMs. In addition, airlines should look to MROs at the initial point of purchase not only to leverage the competition between aircraft manufacturers, but where possible, between MROs and OEMs. Airlines need strong competitive MROs to ensure that competition between the independent MROs and OEMs is maintained.

Understanding the interplay between aircraft reliability, total lifecycle aircraft operating costs, spare assets (including aircraft), fuel economy, and the monthly ownership costs will give airlines a competitive advantage over rivals that stick to the old methods of aircraft purchasing.

As airlines ready themselves for the next cycle of profitability and large fleet refreshes, they need to ask themselves, "Can we tip the scales back in our favor?"

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