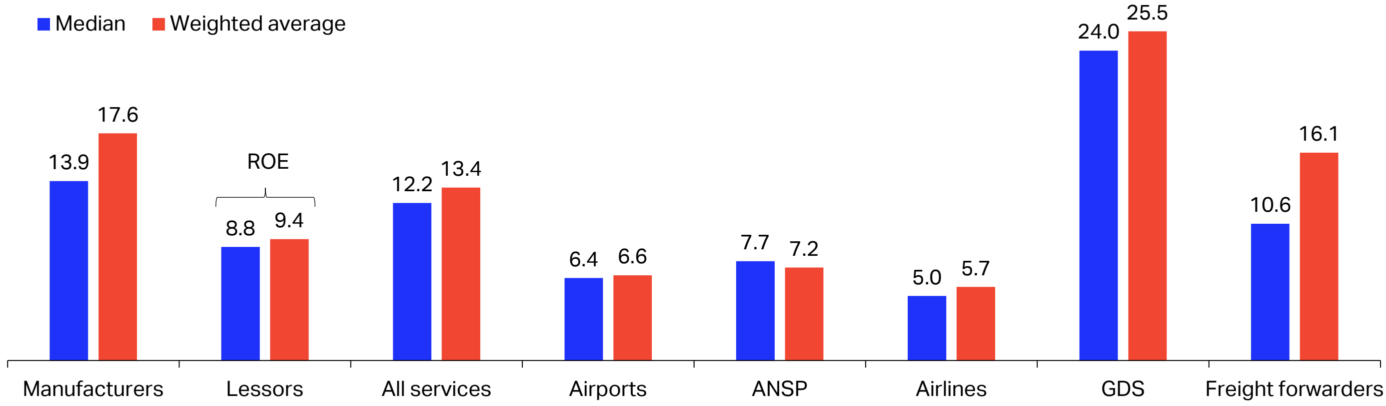
IATA Economics' Chart of the Week

8 July 2022

Outsized market power in parts of the aviation value chain

Operating performance varies throughout the value chain

ROIC excluding goodwill of sample, period 2012 - 2019, %



Source: "Air Travel Value Chain Analysis", McKinsey and Company, December 2021

- While airlines' financial performance has improved at an impressive pace, going from a loss of close to USD 138 billion in 2020 to a forecasted shortfall of USD 9.7 billion in 2022, it remains a fact that most airlines have not as a rule been able to deliver regular profitability over extended periods of time (with the notable exception of the decade immediately preceding the COVID-19 crisis).

- Analyzing the aviation value chain reveals how the returns on invested capital (ROIC) vary greatly among its participants (see chart above). Over the 2012-2019 period, airlines' ROIC was 5.7% on average, clearly at the bottom of the spectrum. At the opposite end, recording 25.5% average ROIC, we find the limited number of participants in the global distribution system (GDS). Similarly, as we go down the performance ranking, we note that higher ROIC correlates closely with a relative lack of competition in that part of the value chain.

- Typically, there are only two or three significant participants in the upstream aviation value chain. These industries therefore operate as an oligopoly. Airports are often monopolies as nearby competing airports are a rarity. The number of airlines in the world, however, is well in excess of 1,000.

- The fact that the upstream value-chain participants consistently record superior profits compared to the hypercompetitive airline industry reveals the exercise of market power which their oligopolistic or monopolistic industry structure confers upon them. Indeed, one of the main disadvantages of such industrial concentration is that it tends to lead to higher prices as their customers have few alternative suppliers. In addition, it stifles innovation, disincentivizes investments, produces fewer choices for customers, impairs the quality of the products and services offered, and augments the power to protect vested interests.

- Airlines, however, operate in a hypercompetitive environment that has delivered enormous benefits to its customers as ticket prices have fallen by around 50% on average in real terms over the past 30 years. This is an evolution that has brought with it exactly the growth upon which all participants in the value chain depend.

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