AIR FRANCE-KLM SWOT ANALYSIS

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1. Executive Summary

The “Air France-KLM” Group was founded in 2004 as result of the merger between French flag-carrier Air France and the Dutch flag-carrier KLM (Airfrance-Klm, 2018a).

AF/KL is a member of SkyTeam Alliance, a global aviation partnership, comprised of 20-member airlines and forming a global aviation network operating 16,609 daily departures to 1074 destinations in 177 countries (Skyteam, 2018a).

In 2017, AF/KL alone served 328 destinations in 118 countries and currently, serves 314 destinations in 116 countries. (Airfrance-Klm, 2018a).

AF/KL leads the global aviation industry in three main business areas; passenger transportation, cargo transportation and aeronautics maintenance (AF-KL Report, 2017).

AF/KL shares were traded in the stock exchanges (Euronext Paris and Amsterdam) at the price of €8.574 on the 17th April 2018, thus demonstrating the group’s management and financial success, which ensures investors’ demand and continued support.

Furthermore, it is the twelfth-time consecutive year the Group is included in the “Dow Jones Sustainability Indexes (DJSI World and DJSI Europe)” and ranked as Leader of the “Airlines” sector by RobecoSAM (AF-KL Report, 2017).
2. MARKET ANALYSIS

2.1. Overview of the industry:

KPMG (2018) states that “The airline industry is experiencing an extended period of growth and profitability”, but also warns that increasing competition and rising operational costs will soon shrink the industry’ profit margins.

1 - Number of scheduled passengers boarded by the global airline industry from 2004 to 2018 (in millions) source: statista

2.2. Size of the target market:

In October 2017, IATA confirmed more than 7% increase in air-travel compared to 2016 (IATA, 2017a).
The 2017 edition of “IATA World Air Transport Statistics”, showed that airlines carried 3.8 billion passengers in 2016, representing 242m more air-trips than in 2015. Airlines in the Asia-Pacific area carried the largest number of passengers;

2 - Source: IATA (2017)

The chart below shows the Market share per region:

3 - Source: IATA (2017)
The “New Model Airlines”- (including Low Cost Carriers - LCCs), transported 28.3% of the total of passengers in 2016 and “Network carriers”, 69.5% of total passengers. Leisure carriers transported 2.2% of the total of passengers:

4 - Source: IATA (2017)

All measurements are represented as a factor of revenue passenger kilometers (RPK).
3. Industry Type:

IATA distinguishes airlines into traditional / legacy, low–costs, and leisure carriers; based on their marketing strategy (IATA, 2017a).

AF/KL group places itself in the traditional / legacy segment, however, subsidiary airline companies, namely, HOP!, Transavia and JOON are included in the low-cost / hybrid segment.

According to AirMundo (2017), the AF/KL group (including HOP!, Transavia and JOON) occupied the 5th position of the “Top 20 largest airlines Europe, 2017”. This means that the strategy of combining both FCC and LCC into the group’s portfolio - therefore targeting a diverse scope of clientele - brings positive outcomes.

It is important to mention that other European Groups are following this same strategy, namely; Lufthansa Group (Lufthansa, Eurowings, Swiss, Austrian Airlines, Brussels Airlines) and IAG Group (British Airways, Iberia, Vueling, Aer Lingus, LEVEL).

![TOP 5 European Airlines 2007](image)

5 - Source: IATA (2017)
• **Industry Category:** Core business – FCC (worldwide), complemented by LCC (European market).

• **Industry Characteristics:** According to Slack et al. (2004), customer satisfaction depends on the basic performance of the five objectives that one company must meet in terms of operations, thus; Cost, Quality, Speed, Dependability and Flexibility. While the LCC model works only towards a partial-satisfaction of these objectives (cost, flexibility and dependability), the LCC model tries to meet all five objectives simultaneously.

• **Trends:** Inmarsat (2018), lists the aviation trends as;

  - Rise of premium economy
  - Sweet seating (customized seats)
  - Robot helpers
  - Self-service ID
  - Biometric entertainment
  - Introduction of virtual reality (VR)
  - Connected ancillaries (e.g. Wi-fi, video streaming)
  - Book a taxi in the sky (Flight-path 3D)

It is noticed that the airline industry will have to significantly increase investment in “New Technologies of Information” to please an increasingly more demanding customer base. The offer of these value-added services will bring extra revenue to airlines but will also demark a clear divide between FCC and LCC services.

• **Stability:** 2017 was an extraordinary year for low-cost airlines (IATA, 2017a), and 2018 seems to be another year of exceptional growth, with most of European LCCs creating international hubs and starting regular services to long-haul destinations (Inmarsat, 2018).
However, the pressure imposed by LCCs into the market, makes it more difficult for FCCs and Leisure carriers to position themselves into new routes. A good example of this is the recent collapse of Monarch airlines, which due to the loss of core routes, was unable to adapt its heavy FCC structure and to compete in new markets, already predominantly taken by LCC’s (CAA, 2018, Topham and Obordo, 2017).

- **Market Segmentation**: It is obvious that AF/KL intends to meet the expectations of a large spectrum of customers, by offering competitive products either in terms of “Destinations”, “Quality of Services” and “Prices”.

- **Total Available Market (TAM)**: By targeting a “balanced customer base”, AF/KL breaks the market down into groups of customers, each with different needs and different characteristics (Kotler et al. 2002). As differentiated products target different base segments, the Group’s business expands on both FCC and LCC markets.

- **Serviceable Available Market (SAM)**: Air France and KLM can offer worldwide air-services. Currently, Africa, Latin and North America and Far-east are considered “core destinations”. AF/KL strategy rests in providing Quality “owned” services but, it also
relies on Skyteam’ Alliance partners (mainly China Southern, Delta and AeroMexico). The Group’s LCC’s focus (Hop!, Transavia and JOON) is solely on intra-European traffic, relying on two major hubs: Paris and Amsterdam.

- **Market Segments:** The group’s strategy aims to offer services tailored to all the aviation segments – First Class, Business Class, Premium Economy, Economy and Mini-economy (FCC); Hybrid services (HOP! and Transavia) and Low-Cost services (JOON).
4. Target Market:

- La Première (First Class).
- Business Class.
- Premium Economy.
- Economy.
- Mini-Economy.
- European Low-cost.

- **Competition:** AF/KL’s main competitors are: Lufthansa Group (Lufthansa, Eurowings, Swiss, Austrian Airlines, Brussels Airlines) and IAG Group (British Airways, Iberia, Vueling, Aer Lingus, LEVEL).

- **Direct Competitors:** Lufthansa Group and IAG Group. Also, Ryanair and EasyJet in the Low-Cost segment.

- **Status Quo:** AF/KL strategy is similar to both Lufthansa and IAG Group’s. However, it's performance in relation to them seems to be inferior.

- **Messaging:** AF/KL aims towards a leading position in the global aviation industry.

- **Uniqueness:** A high-end range of services are available in both European and Inter-continental routes. The Premium-economy segment in long-haul flights was an innovative model that has been copied by competitors.
5. SWOT Analysis:

The SWOT analysis below assesses AF/KL business in the current environment, in terms of strengths and weaknesses (internal), and opportunities and threats (external). This analysis intends to find: how the identified strengths can help AF/KL to maximize opportunities and minimize threats; how the identified weaknesses can slow AF/KL’s ability to capitalize on the opportunities; and how the weaknesses might expose AF/KL Group to threats.
• **Strengths:**

✓ The loyalty program Flying Blue, allows passengers to acquire Miles that can be later redeemed into services (such as excess baggage or lounge access) or even tickets. The more one flies with Air France, KLM and SkyTeam partners, the more benefits one will earn.

✓ More balanced network (global coverage compared to IAG and Lufthansa).

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**Figure 6** - Top 10 Airports in Europe - source: AirMundo
✓ Brand ownership - KLM is the world’s oldest scheduled airline, founded in 1919 and Air France in 1933. The longevity of both brands is a real asset for the group.

✓ Modern and upgraded fleet comprised of:

- Regional: Embraer 135/145/170/175/190, Canadair Jet 700/1000 and ATR 42/72 aircraft;
- Medium Haul: Boeing 737-700/800/900, Airbus A321, Airbus A320, Airbus A319 and Airbus A318 aircraft;

✓ Strong current investment in new technologies – “Air France-KLM leverages the power of digital by offering its customers ground-breaking services to simplify travel. Passengers can now exchange emails with friends or customers during flights and enjoy an expanded offer of inflight entertainment” (AF/KL Annual Report, 2016). This is one example of AF/KL’s appreciation of the future importance of IT (as an ancillary service) in the Aviation Industry.
Weaknesses:

- Air France staff unions’ power – “Another strike hits as a warning has been issued by Air France staff unions for Wednesday 18, Monday 23 and Tuesday 24 April 2018” (AF, 2018). The frequent Air France strikes have been negatively impacting the group’s operating results.

- Brand confusion – Despite Air France and KLM both being long established brands, Transavia, HOP! and JOOM are not always perceived by the public as AF/KL companies, namely, due to the visible internal rivalry and implemented marketing strategies frequently confusing the consumer (CAPA, 2015).

- Slow recovery from accumulated operational losses – AF/KL has reported a €216 million net loss in the first quarter of 2017 (Moores, 2017). The final 2017 net result was +€1,155 million, up €363 million compared to 2016 (Nasdaq, 2018). This “recovering period” allowed the group’s strengthening in terms of cash flow, but it might have been the reason for a temporary reduction of services on long-haul routes.

**Significant strengthening in the financial structure**

<table>
<thead>
<tr>
<th>In € million</th>
<th>Fourth Quarter 2017</th>
<th>Change 2017</th>
<th>Full year 2017</th>
<th>Change 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow before change in WCR and Voluntary Departure Plans, continuing operations (€m)</td>
<td>365</td>
<td>-142</td>
<td>2,769</td>
<td>+402</td>
</tr>
<tr>
<td>Cash out related to Voluntary Departure Plans (€m)</td>
<td>-41</td>
<td>-21</td>
<td>-141</td>
<td>+87</td>
</tr>
<tr>
<td>Change in Working Capital Requirement (WCR) (€m)</td>
<td>97</td>
<td>79</td>
<td>270</td>
<td>+203</td>
</tr>
<tr>
<td>Net cash flow from operating activities (€m)</td>
<td>411</td>
<td>-86</td>
<td>2,898</td>
<td>+692</td>
</tr>
<tr>
<td>Net investments before sale &amp; lease-back* (€m)</td>
<td>-503</td>
<td>-106</td>
<td>-2,202</td>
<td>-343</td>
</tr>
<tr>
<td>Operating free cash flow (€m)</td>
<td>-87</td>
<td>-134</td>
<td>599</td>
<td>+346</td>
</tr>
</tbody>
</table>

*Figure 7 - AF/KL cash Flow - source: Nasdaq*
• **Opportunities:**

✓ Low-Cost market – With three airlines adopting the low-cost model, AF/KL makes a good use of their PAR/AMS hubs, which has been consistently increasing the groups’ presence in such a competitive market.

✓ AF/KL North Atlantic join venture with Delta and Virgin. The recent acquisition of a 31% stake in Virgin Atlantic, on top of a 49% stake already owned on Delta Air Lines, (Martin, 2017) makes the group' strategy for the USA a probable success.

✓ Short/medium haul business – Since 2017, AF/KL has been implementing network reductions, cost cuts and reorganizing Hop! and Air France short-haul services into a single structure. This strategy allows the reinforcement of the customer's “value for money” perception of the AF/KL group brand against LCCs (CAPA, 2015).

✓ AF/KL fleet renewal benefits both unit costs and customer perception - A modern fleet allows the Group to offer extra comfort, savings on fuel and meet its CSR commitments (by reducing greenhouse gas emissions and noise pollution). This is a good opportunity, not only implying a reduction of operating costs, but also building on passenger appeal and branding (CAPA, 2015).

✓ The investment in the “Go Around The World With Skyteam” strategy, based on the development of code-shared flights within the Alliance, strengthens the group’s presence in high-value markets, such as: China (China Southern and China Eastern Airlines), North America (Delta, Virgin Atlantic), Latin America (AeroMexico), Africa (Kenya Airways), and Europe (Alitalia) (Air FranceGB, 2018; Routes online, 2018).
• **Threats:**

✓ LCC competition – The main competitors (Ryanair and EasyJet) are specialists in Low-Cost and their approach to the market is very aggressive, most of the time they are also backed by local governments, by establishing agreements for the reduction of taxes, through co-participation of costs, incentives or even subsidies (The connexion, 2018).

✓ High competition on long-haul – Besides IAG and Lufthansa groups, AF/KL has to compete in the long-haul market with three big Gulf carriers (Emirates, Qatar Airways and Etihad) that are rapidly developing their presence in the European market and are perceived by the consumer as “Excellence” airlines.

✓ Fast Train routes - the Eurostar Train Service from London to France and Netherlands has been hitting the group’s position in traditionally strong, profitable routes, mainly with regards to business class passengers (Calder, 2018).

✓ Persistently high fuel costs can reduce margins – Managing costs has been the group’s primary concern since 2015 (AF-KL Report, 2017). This task might be compromised by the present volatility of the fuel market (Bryan, 2018).

✓ Labor costs - Higher wages and industrial action threatens AF/KL’s financial stability. 10 Air France unions have called for another strike to push a 6 percent pay rise (The Local, 2018). Bryan, (2018) states: - “Labor costs surpassed fuel as global airlines’ biggest single expense in 2016, at 22 percent of costs against just under 21 percent for fuel. That is expected to jump this year to 30.9 percent versus 20.5 percent for fuel".
6. Future Directions

In 2018 the AF/KL Group intends to raise its capacity on routes to Asia and Latin America, therefore meeting the rising demand (Travel Weekly, 2018). In February 2018, the group announced the list of new destinations: Nairobi, Mahe, Catania, Wroclaw, Vaxjo, Bergen, Fortaleza, Seattle and Taipei, using a versatile fleet comprised of: Boeing 787-9 Dreamliner, Boeing 777-200/300, Airbus A340, Airbus A319/320, Embraer 70 and Embraer E175 (Aviate World, 2018).

To fight competition by the new high-speed train routes, mainly in France, the group is now offering the consumer a "Train + Plane" Trip With “TGV-Air” (AF, 2018b), intended to develop during 2018.

The group’s LCC “JOON”, is expected to start long-haul, low-cost services to North America, mirroring Norwegian; and to Brazil and Seychelles (Morris, 2017). In 25 March 2018, Joon operated its first long-haul flight to Cairo (AF, 2018d). However, CFO Frederic Gagey said: “it seems that launching low-cost long-haul flights without connecting services is challenging” (Travel Weekly, 2018).

An increase of capacity by 4% in long-haul flights was projected for 2018 as a consequence of strong results in 2017, which were “boosted by a positive business environment”. The good news is that the summer schedule already verified a 4.1% increase in capacity and 78 new services across the long, medium and short-haul (AF, 2018c).

2018 will also be the year for the group to completely embrace digital technology. Jean-Christophe Lalanne, CIO at Air France-KLM stated: “We’re spending about €400 million on digitization during the next three years”; “The core aim is to place high-quality customer experiences at the front and center of business operations.” (Hot Topics, 2018).

The Chairman Jean-Marc Janaillac, cited in Travel Weekly (2018), stated: “As we enter 2018, in a context of rising oil prices and even more intense competition, we will pursue the offensive, (...) to maintain a profitable growth momentum.”

Thus, it seems that the group’s path is well-drawn, and its success is foreseen.
7. Conclusion and Recommendations

By the above, one can state that the economic recovery produced by the Air France-KLM group during 2016 and 2017 is impressive. The adjustments made in terms of cost-reduction, staff adjustments and out-stations reconfiguration (AF-KL Report, 2017), were only possible due to well-planned change management.

This business turnaround resulted from the group’s acknowledgement and correct identification of its problems. By considering necessary changes it was possible to develop and implement an efficient problem-solving strategy (Investopedia, n/d).

However, factors such as fuel prices, fraud and cybercrime, financing and interest rate fluctuations may threaten the group’s stability.

Thus, a list of recommendations is produced:

- Develop the business within SkyTeam - allowing the group to serve a larger number of destinations;
- Develop the group brand, reinforcing the affiliation of HOP!, Transavia and JOOM through social media and other channels – increasing consumer trust on the low-cost services offered;
- Develop processes to take further advantage of AMS and CDG Hubs – these two powerful Hubs can be explored to gain competitive advantage in the LCC market;
- Develop the ties with the Northern American market, through the creation of more code-shares between the Group and participated airlines (Delta and Virgin Atlantic);
- Increase the capacity on routes that are successful in the South American market, either by change to aircraft configuration or by reinforcement of code-share flights with AeroMexico;
- Additional investment in Transavia’s Marketing budgets and in new routes throughout Europe to increase its profitability and public awareness – Transavia is already considered a top-level low-cost carrier in France and Netherlands;
- Resolve Air France’s industrial disputes – mainly with regards to cabin crew strikes;
• Resolve KLM’s Pension scheme deficit – in 2017 the AF/KL net loss of €274m was due to a €1.4bn charge linked to the new pension deal for KLM pilots and cabin crew (CNBC, 2018).

• Implementing better software solutions to deal with the extremely high level of missed connections and involuntary boarding compensations (AF-KL Report, 2017) – allowing better flight schedule management and reduction of compensation payments.

The implementation of the above recommendations – in the short/medium term - would bring extraordinary benefits to the group.


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