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Where are the elephants in the room?

About markets, products and yield...

Typical discussion topics at air cargo industry gatherings are declining yields, tougher government regulation on security, modal shift to sea transport, and the lack of streamlined processes and IT systems. These concerns are legitimate, however, what surprises me is that some cargo executives do not seem to observe the elephants in the room.

The air cargo market has an a-typical supply market set up. While the top 50 airlines carry three quarters of the air cargo, the market shares of the top 10 airlines are still relatively small. In addition, the strategic objectives of these airlines are not aligned. There is lack of a 'natural' industry leader, or at least an airline who takes up leadership and carries the industry flag in front. Most similar industries with this supply side organization have at least one industry leader who stands up, dominates the discussions, and sets the standard. The three huge integrators FedEx, UPS and DHL work independently in expanding their market, pushed by the worldwide growth in E-commerce. In addition, these integrators are exploiting their year-by-year increasing economies of scale, scope and density in their respective door-to-door networks, making it increasingly difficult for a new player to enter the lucrative door-to-door market. Emirates works hard on its impressive expansion, Lufthansa and Air France/KLM are fighting to get back in the black respectively, and Korean Air, Singapore Airlines and Cathay Pacific have their own issues. What about the US companies who traditionally like to take up the worldwide industry lead? The big three US airlines already lost the cargo game to the two remaining integrators in the US, UPS and FedEx, and play only a minor role internationally.

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Another often neglected fact is that the air cargo industry product is a derived demand from the worldwide trade in merchandise goods. This means that we cannot really influence aggregate demand for air cargo by lowering the price. According to the basic supply and demand economic theory, a lower price creates additional demand. Low cost airlines like Ryanair and Air Asia prove that this works very well for the air passenger business. However, this economic rule does not really apply to the air cargo industry. This means that a cargo industry player can only expand by taking business away from its competitors, as the air cargo market is a zero-sum-game market. In addition, new wide-body passenger aircraft like the B787 and A350 are becoming increasingly cargo friendly compared to their predecessors. This generates a close to zero marginal cost environment to transport additional air freight on board a passenger aircraft. Hence, the reduction in yields reinforced by the expansion of a number of fast growing airlines in the Middle East and Asia. A small addition to the capacity in the air cargo industry leads immediately to an equilibrium with a disproportionate lower price.

The impressive expansion plans of the ambitious players in the Middle East and Turkey are well known. The big three Middle Eastern airlines alone will add about 10 million tons of wide body cargo capacity over het next decade. Only about 60 million tons of air cargo are yearly internationally transported. These 10 million tons will be added onto the only partly utilised worldwide yearly network capacity of 120 million tons of cargo. Not counting the additional planned wide body capacity growth by Turkish Airlines and some Chinese airlines, this additional capacity in the air cargo zero-sum-game environment will lead to even stronger yield reductions, as capacity growth significantly outstrips the demand growth.

The air cargo industry is still growing thanks to the increased worldwide trade and cross border E-commerce flows, mainly to and within Asia. However, the integrators seem to skim off the lucrative part of this E-commerce transport by dominating the total door-to-door supply chain both commercially and operationally. This leaves little room for the traditional cargo airlines to play a role, apart from selling their cargo capacity as general cargo to transport the overflows of the operators.

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The elephants are in the room and have no intention to leave. Results can already be found in the yields and cargo load factors of traditional airlines. The lack of an industry leader, the fact that the cargo product is a derived demand, the additional cargo capacity added into the networks, the production of this capacity in a close to zero marginal cost environment and the zero-sum-game market are very specific feature one hardly finds back in other industries. Surprised the yields are declining? You ain't seen nothing yet... Fasten your seat belts!