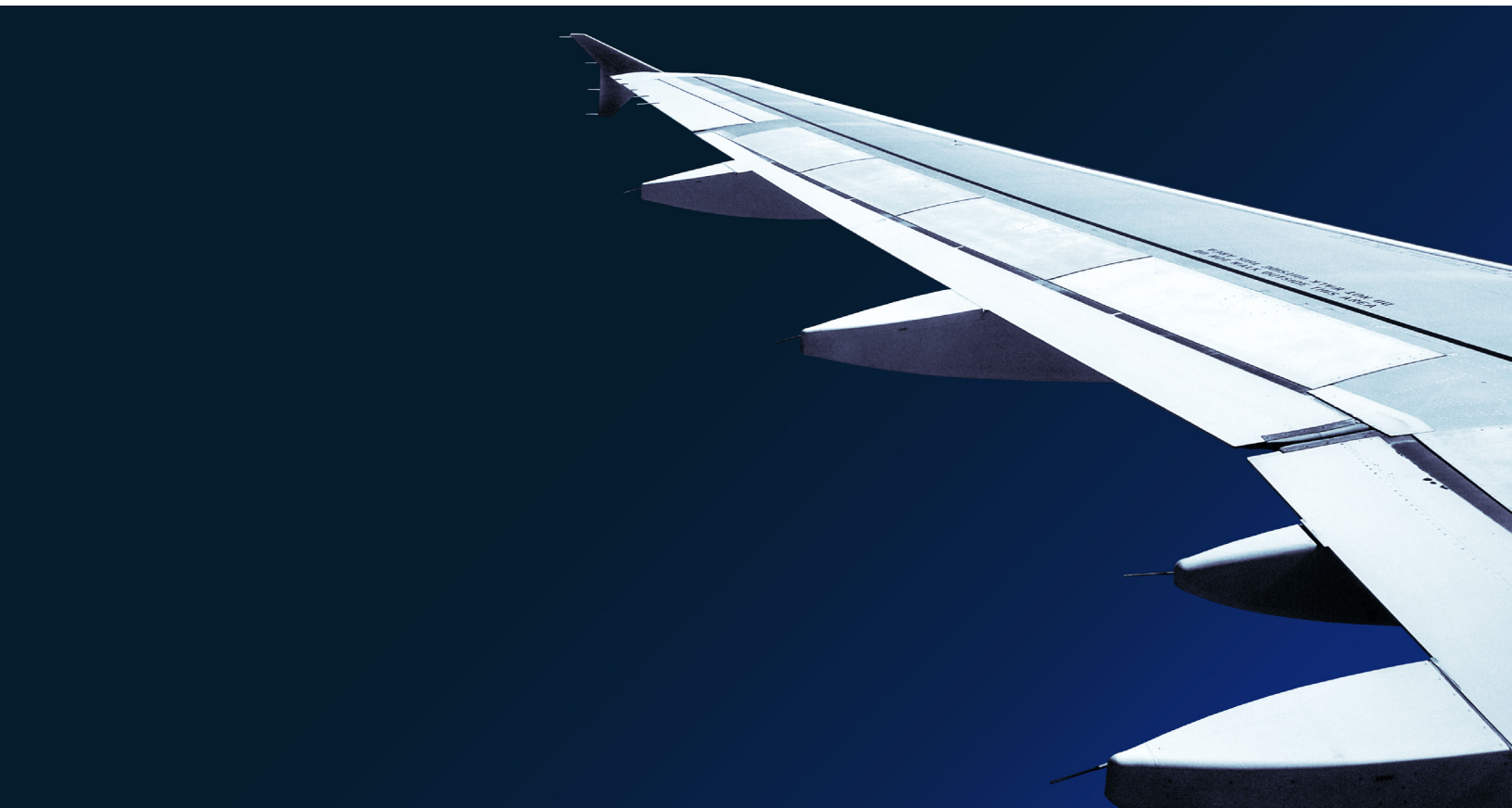


Travel, Logistics & Infrastructure Practice

# Coronavirus: Airlines brace for severe turbulence

COVID-19 has brought travel to a sudden halt. Airlines need strategies for navigating the crisis and returning to the skies.

*by Andrew Curley, Alex Dichter, Vik Krishnan, Robin Riedel, and Steve Saxon*



**Only four months after** the first case of COVID-19 was reported in China, the disease has spread worldwide and afflicted well over two million people. To curb the spread of coronavirus, many countries have taken extreme measures, including quarantines and border closures. As of early April, 2020, 91 percent of the world's population lived in countries that limited or forbid the entry of noncitizens and nonresidents.<sup>1</sup>

In addition to the human toll, COVID-19 is devastating the global economy. Although almost every sector feels some repercussions, few have been as hard hit as the airline and travel sector. The sudden, sharp decrease in travel demand is much worse than that seen after September 11, 2001, and the 2008 financial crisis, combined. Airlines had more robust balance sheets when COVID-19 emerged, compared with previous crises, but a slowdown of this magnitude leaves even the strongest players vulnerable.

Most airlines have sufficient short-term liquidity to survive the next three to six months, despite the sudden plunge in revenue. Some airlines have declared bankruptcy, but governments are also stepping up and providing financial support to ensure that airlines remain solvent. But the long-term picture raises concerns. Airlines will not return to normal operations and demand levels until 2022 at the earliest—and when they do, it will be in a world forever altered by COVID-19. That means 2020 will be a balancing act, as airlines simultaneously attempt to stabilize their business while preparing for demand recovery, all while operating in an uncertain landscape where the usual assumptions about traveler behavior may no longer apply.

### **The end of normal: Current airline demand**

With the closure of international borders and imposition of stay-at-home directives, travel demand is almost nonexistent. In the United States

alone, travel spending for 2020 is expected to decrease by around \$400 billion, translating into a loss of about \$900 billion in economic output.<sup>2</sup> These numbers mean that COVID-19 would have more than seven times the impact of September 11, 2001, on travel-sector revenues.

Worldwide, airline capacity is down 70 to 80 percent in April 2020, compared to April 2019, and multiple large airlines have temporarily ceased operations. Overall, almost 60 percent of the global fleet was grounded in early April 2020.<sup>3</sup> Again, a comparison with previous crises provides some perspective. US airline capacity was down more than 70 percent in early April 2020, compared with April 2019 (Exhibit 1). Those drops far surpass the year-on-year declines of 19 percent after September 11 and 11 percent after the global financial crisis of 2008. Likewise, we estimate US airline load factor is now down about 70 percentage points, well above the drops seen with prior crises.

With fleets grounded or most passenger flights cancelled, airlines are directing their energies to assisting with coronavirus-relief efforts. Many planes that typically fly people now transport cargo, including medical supplies used to fight COVID-19. Some airlines are also providing medical workers with free round-trip flights to New York City and other hard-hit areas, while others are helping by seconding staff into areas that need extra hands, such as medical facilities and grocery stores. These steps are a natural and much-needed first response to the crisis.

### **Looking ahead: How airline demand might evolve**

Of course, everyone hopes that the coronavirus is quickly contained and that a vaccine or effective cure becomes available, but it is also necessary to consider alternatives. Another McKinsey article, "Safeguarding our lives and our livelihoods: The imperative of our time," presents nine scenarios

<sup>1</sup> Phillip Connor, "More than nine-in-ten people worldwide live in countries with travel restrictions amid COVID-19," Factank, Pew Research Center, April 1, 2020, [pewresearch.org](https://www.pewresearch.org).

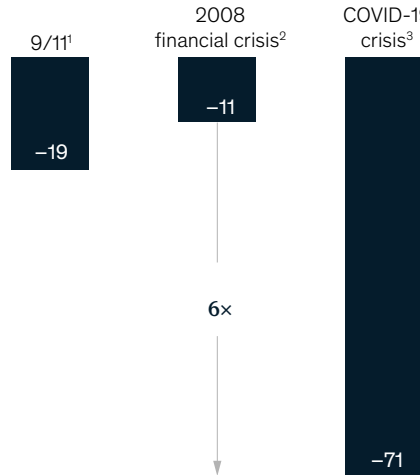
<sup>2</sup> *The economic impact of the coronavirus due to travel losses*, Oxford Economics, March 2020, [ustravel.org](https://ustravel.org).

<sup>3</sup> Andrew Doyle, "Tracking the in-storage fleet and utilization in a time of uncertainty," Cirium, April 2020, [cirium.com](https://www.cirium.com).

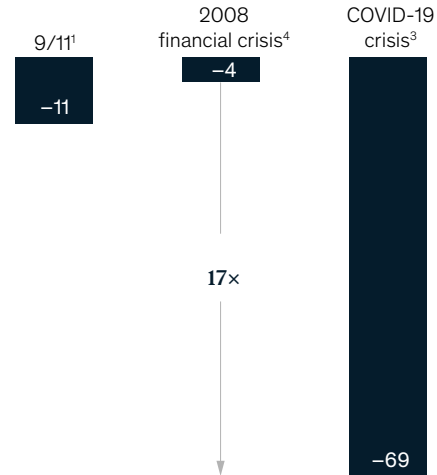
Exhibit 1

**COVID-19 has created an unprecedented crisis for airlines.**

**US airline available seat miles, year-over-year % change**



**US airline load factor, year-over-year percentage point change**



<sup>1</sup>Year-over-year change Sept 2000 vs Sept 2001. <sup>2</sup>Year-over-year change Feb 2008 vs Feb 2009. <sup>3</sup>Year-over-year change April 2019 vs April 2020. <sup>4</sup>Year-over-year change Mar 2008 vs Mar 2009.

Source: A4A; USDOT T100; press search

that illustrate how the COVID-19 crisis might evolve, depending on the success of containment efforts, government policy, and other factors. When examining how global travel demand might recover, we focused on two of these scenarios: one in which the pandemic resolves relatively quickly and one that takes a more pessimistic view. These divergent scenarios allowed us to envision and plan for two very different outcomes at a time when uncertainty reigns.

Even in the more optimistic scenario, in which the spread of coronavirus is rapidly and effectively controlled, air travel still drops by almost 50 percent in 2020. But, in this scenario, governments create strong economic interventions, travel bans start lifting as COVID-19 cases drop, and the global economy begins recovering in early May. Simultaneously, airlines successfully stimulate demand by lowering ticket prices. People resume

their normal behavior, with no lasting differences, and airlines ramp up operations. Global travel returns to pre-crisis levels by 2021 and exceeds them in the following years.

In the more pessimistic scenario, a coronavirus resurgence requires long-term mobility restrictions, economic interventions are weaker, and governments maintain travel bans for longer. As in the more optimistic scenario, airlines cut prices to stimulate demand but see limited gains. For leisure travelers, the combination of economic uncertainty and fear of infection results in low demand. On the business side, some work trips are replaced with the videoconferences that have become the norm during the pandemic. Air travel demand drops by about 60 to 70 percent in 2020 and does not recover to pre-crisis levels until 2023 or even later.

# Airlines must ensure that they have sufficient cash on hand to fund their short-term operations.

## **In a holding pattern: Immediate actions required to maintain operations**

With revenues plummeting, airlines must ensure that they have sufficient cash on hand to fund their short-term operations. Although many large airlines have enough cash to cover more than six months of zero-capacity operations, others have had to draw on available credit lines that they established pre-crisis. While some are also investigating new loans, for which they would use aircraft, real estate, and other unencumbered assets as collateral, they may have difficulty securing the funding. After all, the value of their assets has dropped sharply as demand contracts. Smaller, regional airlines are especially vulnerable to financial pressures. Widespread ratings agency downgrades could trigger breaches of covenants on debt agreements and increased holdbacks by credit-card issuers, cutting into airline working capital at a critical juncture.

Governments have already stepped in to help airlines sustain liquidity, and several are considering various financial-aid packages for them, including the following:

- Direct subsidies, designed to supplement company cash flow, which are generally distributed evenly to all industry participants; these may come with certain conditions, such as the need to maintain employment levels.
- Direct financial aid, such as government loans, or guarantees to ensure debt provision from financial institutions; these can have various structures and covenants, such as requirements to have an oversight board, time restrictions, or other limits on corporate governance.
- A reduction in, or waivers of, government-controlled taxes or regulations, such as landing fees; these incentives encourage airlines to keep operating, since they cannot collect benefits unless they are active.

The United States has already answered a call for relief from airlines through the Coronavirus Aid, Relief, and Economic Security Act (CARES) stimulus package, which earmarks \$50 billion in loans and salary support for passenger airlines. Other countries, including Finland and Norway, have started to extend loans to airlines.

With government support varying by country, some airlines may receive a competitive advantage and emerge from the crisis stronger than they were in the past, relative to their competitors. For others, of course, the opposite may be true.

## **Preparing for take off: Next steps for airlines**

After airlines have addressed their immediate liquidity issues, they require a plan that guides

them through the ongoing coronavirus pandemic and its aftermath. They may find a path forward by following a framework that McKinsey created to assist companies on their journey to the next normal. It guides companies through five phases: Resolve, Resilience, Return, Reimagine, and Reform. We have identified the questions and issues that companies must consider along this journey, with some being relevant during multiple phases (Exhibit 2).

**Resolve and Resilience: Surviving through the crisis**

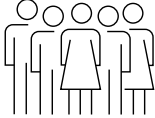

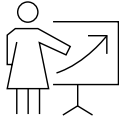

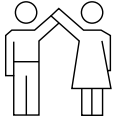
Most airlines are now focused on staying in business and keeping the lights on. But they will benefit their customers and employees much more if they also think strategically during this difficult time and consider challenging questions. Take liquidity issues. Will airlines need to adhere to certain operational requirements, such as continuing certain flight

routes, if they accept government assistance? And if they use assets as collateral to improve liquidity now, will that restrict their use in the future? If airlines fail to address such questions until late in the crisis, they might not recognize the long-term consequences until it is too late to reverse course.

With travel at record lows, airlines will also benefit from developing new strategies to connect with customers, who probably are not flying, and employees, who may not be working. And looking ahead to the day when travel restrictions lift, airlines might want to begin thinking about adjusting their health and safety operations now. Passengers may be hesitant to travel even after the coronavirus is contained, believing that airports and planes might expose them to infection, and employees might have similar concerns when returning to work. Many airlines have already adopted new safety

Exhibit 2

**The questions airlines must address will evolve as they navigate the crisis.**

 <b>Resolve</b>	 <b>Resilience</b>	 <b>Return</b>	 <b>Reimagination</b>	 <b>Reform</b>
<ul style="list-style-type: none"> <li>● As the <b>immediate liquidity situation</b> becomes more clear, what are the second order implications for the industry (eg, operating model changes, government conditions)?</li> <li>● For <b>safety of customers and employees</b>—what more can we do? What role does the industry have in shaping this? (vs governments)</li> <li>● How can we continue to <b>build engagement</b> with employees (who may not be working) and customers (who may not be traveling)?</li> <li>● How can we help <b>fight the coronavirus</b> (for instance through emergency cargo flights)?</li> </ul>	<ul style="list-style-type: none"> <li>● What are the characteristics of <b>early demand</b> (eg, segments, geographies), and what signals should we be watching?</li> <li>● What will it take for people to <b>feel comfortable traveling</b> again? Can travel be stimulated?</li> <li>● How can we ensure we capture (at least) our fair share of <b>nascent demand</b>?</li> <li>● How do we prime our <b>operations and commercial functions</b> to scale appropriately?</li> </ul>	<ul style="list-style-type: none"> <li>● How will the <b>characteristics of demand or supply</b> change (eg, who will travel, where, why, how)? What do we already know? How much “smaller” will the industry be in 2021, 2022, or later?</li> <li>● How will <b>end-to-end customer journeys</b> change (eg, expectations, behaviors, innovations)?</li> <li>● How will the <b>travel value chain</b> change (eg, who will emerge stronger, weaker, different)?</li> </ul>		

protocols, and others are now developing them. Some of the strategies that Chinese airlines have enacted—requiring passengers to wear masks and taking their temperatures pre-flight or asking for registration of previous and planned travel—might be replicated elsewhere.

### **Return: Ramping up operations**

Airlines will experience a gradual and uneven return to operations that requires an unprecedented logistical effort. Done poorly, their strategy may be as costly as the crisis itself. What's more, airlines must ramp up operations alongside ever-changing health mandates and government guidelines to which they must adhere.

While demand is currently low, airlines can gain an advantage by planning their return to large-scale operations now. It may be difficult to predict when that will occur, so they should carefully monitor early indicators for demand, such as flight-search activity, and examine data to identify customer segment and geographies that may represent new growth pockets.

Consider the Chinese market as an example. Some signs hint at possible demand growth, such as the reopening of many tourist attractions, greater hotel occupancy, and an uptick in public-transport use. A look at ticket sales is concerning, however, since purchases have plateaued after recovering slightly from their nadir. And a close examination of passenger demographics suggests that the current customer base may be very different, with young people and budget travelers predominating. Customer behavior has also changed, with short booking windows—often a week or two—now common as fewer travelers make plans far in advance. Passengers are also mostly booking domestic flights, and international travel is still waiting for its return.

Since travel may take years to reach pre-COVID-19 levels, airlines may have questions about whether they can truly stimulate demand. Although we do not know what new regulations may emerge to govern travel, there could be some time-consuming

additional checks or requirements that discourage business or short-term leisure travelers from taking trips. Regulatory differences between regions may also drive costly complexity in operations and create confusion for customers. Airlines will need to work proactively with one another, regulators, and others in the ecosystem to ensure a smooth and consistent customer experience while ensuring safety.

In this environment, airlines should carefully consider whether any specific incentives or discounts will produce the desired results or simply eat into their financials. While marketing efforts will be essential, as always, their content will change to reflect new customer preferences and concerns.

Again looking ahead, airlines may gain an advantage by thinking about the actions that their competitors are likely to take as travel increases and by determining how they will respond. Taking this step now will help them capture their fair market share—always an important goal, even if demand remains low. Airlines can also prepare by considering which people, processes, and systems must be available when operations begin to ramp up, so they can move quickly.

### **Reimagine and Reform: Becoming stronger than ever**

During these stages, airlines must acknowledge that once dependable patterns may disappear and that the traditional methods for determining prices, flight routes, and passenger incentives may no longer be valid because passenger preferences, demographics, and behavior have shifted. For example, segments that in the past might have been easily lured onto flights with cheap fares and deals might be less responsive to such actions if they still have health concerns. Some governments might also complicate the picture by making unexpected policy changes that restrict travel to or from their countries, even after the pandemic abates. As airlines gather information on these changes, they may need to update their pricing and revenue-management systems because they typically rely on past observations to create forecasts.

In addition to revising their planning processes, airlines may need to adjust the end-to-end customer journey since passengers may have new expectations and behaviors once they begin to travel again. Businesses may be reluctant to have their employees travel, especially internationally, and this may continue for some time. With such changes occurring, airlines may need to update their products, networks, and operations.

Finally, the airline industry itself will be different once the pandemic subsides. Some airlines will be stronger while others will be in a more difficult position than they were previously, or even sidelined altogether. Further consolidation is also likely in the new landscape, as are major strategic changes. With so many changes happening so quickly, and in a time of such disruption, airlines might want to reassess the competitive landscape and abandon any prior assumptions about their rivals before making major decisions.

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Almost overnight, airlines saw travel demand evaporate and busy fleets grounded. With revenues plummeting and continued uncertainty about the pandemic's course, airline leaders may have difficulty looking beyond the next few months. But those that think strategically about managing their return to large-scale operations, reimagining their business, and reforming their organizations to suit the next normal will help both their employees and their customers. Collaboration could be increasingly important to their success in the new world. For instance, airlines could form marketing partnerships with hotels, tourism agencies, and others within the travel ecosystem to increase demand, or assist governments and regulators in creating worldwide or regional standards for hygiene or operations. Such collaborations, as well as other strategic moves, will help airlines resume their primary goal of connecting our world.

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The authors wish to thank Dilip Bhattacharjee, Axel Esque, Guenter Fuchs, Ryan Mann, Aprameya Rao, Darren Rivas, and Kyle Snyder for their contributions to this article.

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