McKinsey&Company




Civil aviation: Turbulence ahead?

August 2013

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The prospect of sustained global demand—and of full order books—may lull civil-aviation players into a false sense of security. There are, in fact, two dark clouds on the horizon: the risk of capital drying up and the risk of the rules of the game being redefined—and there could be many victims.

In 2012—a record year for profits—most civil-aviation players saw double-digit sales growth and had increased profitability across every segment. The order books are still overflowing: 9,500 aircraft at the end of May 2013, equivalent to more than eight years' output. We can add to this number the recent announcements from the 2013 Paris Air Show. It appears that most players are focusing on speeding up production and have put financial and strategic considerations on the back burner.

Unfortunately, the much-feared "scissors effect" on the availability of capital is looking like a distinct possibility. On the one hand, the new aircraft programs (B787, A350) and the increase in output (A320 and B737 families) are generating a considerable need for industrial investment. Working-capital requirements are rising. The operational difficulties of some players are driving others to build up safety stocks, increasing the need for cash even further. On the other hand, the availability of capital is diminishing: still-struggling airlines are stepping up the pressure on prices and are now reluctant to make advance payments, while the banks, subject to new regulations, are forced—despite historically low interest rates—to limit the flow of credit. These two effects are already causing problems for some civil-aviation players, with repercussions for their customers. And this is just the beginning.

The short-term operational and financial challenges are compounded by potential medium-term strategic pitfalls, which suppliers can already see coming. The rules of the game for future aircraft programs, which have been relatively stable until now, will be substantially rewritten as a result of three major changes. First, from a technological viewpoint, demand for equipment will be modified by new architectures ("more electric" aircraft, open-rotor engines, and so on), reducing the value of certain markets (pods or hydraulic equipment) while creating other opportunities (electrical distribution). Secondly, having learned the lessons of recent programs, aircraft makers will review their purchasing policies (for example, by performing internally certain engineering or production activities that used to be outsourced). Over the next generation of aircraft, the core business of certain suppliers is likely to be totally rethought, as will the risk- and profit-sharing model. And finally, competition will become more intense, with the emergence of players from the BRIC countries,[1] both as aircraft makers—with the end of the Airbus/Boeing duopoly—and as equipment manufacturers. Chinese companies are already coming onto the scene in carbon, for example. Tomorrow's aircraft makers will buy different equipment in different ways. It would be a costly mistake to underestimate the strategic impact of these changes on sector players.

So what should we do? First, at the operational level, the watchwords have to be tight cash-flow management and thorough monitoring of weak points in the supply chain. Concepts like "pre-series" from the automotive industry may help to smooth the transition from prototype to serial production. Supplier management also needs to be modulated in accordance with the size and exposure to risk of each segment. At the same time, an in-depth strategic review must be put in place—and quickly.

The winning players will be the ones that best manage to reconcile the different time scales: short-term acceleration, sustainable medium-term financing capacity, and judicious long-term strategic repositioning.

1 Brazil, Russia, India, and China.

This article is an English translation of a French article that originally appeared in *Le Figaro*, June 17, 2013.
http://www.lefigaro.fr/societes/2013/06/17/20005-20130617ARTFIG00715-aeronautique-civile-turbulences-en-vue.php

August 2013
Designed by US Design Center