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Off to a flyer – cash optimisation in the aviation industry

Improving free cash in the airline sector

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BUSINESS OVERVIEW

The company is an international airline with turnover of around £3bn. While the bulk of their revenue is from passenger flights, they also operate a holiday business that represents around 20 percent of turnover.

As with many other airlines, they are feeling the increasing pressure on the sector, due to excess capacity and rising costs. Over the past four years, debt and leverage have increased, while free cash ratios and profits have declined, making insolvency a genuine threat.

Carriers with declining free cash are less likely to refund card payments for un-flown tickets. To offset this increased risk, card acquirers demand less favourable payment terms or request cash collateral, further reducing airlines' cash flow.

THE CHALLENGE

The client was looking to fund a range of new initiatives, including fleet acquisitions, and recognised that additional working capital could be released by streamlining their processes.

They chose Deloitte to help investigate precisely where further cash could be freed up, then to identify and evaluate initiatives that would realise this effectively, drawing particularly on our strengths in data analytics.

OUR APPROACH

We brought in a Value Creation Services (VCS) team, as a small group that could work rapidly to build relationships throughout the company and gain a detailed and nuanced picture of the situation in a short, five-week period.

Our guiding aim was to shorten times for cash coming in, and lengthen times for cash going out. We collected and mapped details of all cash sources and flows, in and out. For each one, we then hypothesised alternative scenarios and tested them with key stakeholders.

Meanwhile, we defined a number of operational KPIs, and created dashboards to monitor them in real time. Behind the dashboards lay a complex data analytics exercise, in which we live-linked and aggregated a massive volume of transaction records, allowing us to bring meaning and insight to the data as it was generated.

We used these tools to identify a number of initiatives that could improve cash flows, and evaluated each initiative according to its speed, complexity and value. By aggregating and charting these options, we created a clear visualisation to help discuss and agree priorities with the client, including identifying the quick wins that would realise the most immediate value.

THE OUTCOME

Based on our diagnosis, we identified 18 initiatives, which could be implemented over the following 18 months, to realise a cash improvement of up to £180 million. Out of those, we agreed to focus on the most material, which delivered £80m of free cash in the following 10 months.

By changing their card acquirer, they secured shorter terms for incoming payments and no collateral. They standardised and extended their outgoing payment terms to suppliers, as well as implemented a best-in-class payment run policy. Reducing the timing between booking and issuing passenger tickets yielded further benefit. We also helped them develop a business case for direct debit payments for the holiday's business, creating better cash flow, offered to customers through a more attractive, online process. Last, we combined our knowledge across transaction services, analytics and restructuring to reshape the client's cash flow forecasting process, and developed tools to make their cash flows more visible and easier to forecast.

KEY LEARNINGS AND OPPORTUNITIES

Where carriers are selling individual flights direct to passengers, their total revenue comprises a large number of relatively low-value transactions, often made through a wide variety of payment channels and methods. Although a small improvement in each transaction can have significant benefits for overall cash flow, the challenge is to develop data analytics that give a clear overview across the scale and complexity of those transactions, to identify and monitor the potential benefits.

Air carriers are particularly dependent on debit or credit card payments, and an important indicator is Days Sales Outstanding (DSO) – the time between the operator issuing a ticket and receiving payment from the card acquirer. However, once payment has been made, card acquirers carry the risk of refunds for un-flown sales, known as Air Traffic Liability (ATL), and corresponding to the period between payment and flight date. As the likelihood of carriers going insolvent or having poor cash flow increases, card acquirers are offsetting this risk by extending their payment terms or requesting more collateral. The DSO therefore can offer an insight into how secure card acquirers believe the local airline sector to be. For instance, payment terms in Europe are about twice as long as the US, because of greater uncertainty due to price wars and exchange rates. Understanding this dynamic can be key to identifying and obtaining payment terms that significantly improve cash flow.

Across the sector, we believe that targeted working capital initiatives such as these could improve free cash by 20 to 40 percent. For the average carrier, even half this improvement could allow an 8 percent increase in capital expenditure, or enough to buy a new aircraft!

VALUE DELIVERED

18	£180m	£80m
Initiatives	Cash improvement identified	Realised

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