Chapter 7
Preliminary Cost Analysis

This chapter examines airline cost structures and its changes over time. It provides a preliminary analysis of the effects of network and operating characteristics, and exchange rate fluctuations on airline costs. Thus, it prepares ground for further analysis of airline cost competitiveness.

7.1 Airline Cost Structure

How an airline's costs are broken down and categorized depends on the purpose for which they are being used. No single cost categorization is capable of simultaneously satisfying all management or policy analysis requirements. As a result, most airlines break down their costs in various ways in order to use them for different aspects of management. For example, a common practice is to divide airline accounts into operating and non-operating cost categories. The former can be further subdivided into direct operating and indirect operating costs. In practice, however, distinctions between direct and indirect operating costs are not clear cut. Certain cost items are categorized as direct costs by some airlines, but as indirect costs by others. According to Doganis (1991), direct costs account for approximately half of total operating costs for world scheduled airlines as a whole. This highlights the importance of indirect costs which may not be assignable to specific traffic.

This chapter examines airline system-wide aggregate annual costs, and classifies costs by factors of production. Recall from earlier chapters, we distinguished five categories of airline costs: labour, fuel, materials, flight equipment, and ground property and equipment. Figure 7.1 gives an indication of each airline’s 1995 total cost and contribution of different cost elements to total cost. Note that total cost here refers to an airline’s total input costs which include costs of flight equipment and GPE capital. The cost of materials inputs (purchased goods and services) accounts for between 35 percent (Iberia) to 57 percent (SIA) of total cost, thus being the most important component. Many factors contribute to the large variations in the share of materials cost, including differences in airport charges and en route charges (Comité des Sages, 1994), and varying degrees of operations and services outsourcing.

Labor costs represent between 11 percent (SIA) to 42 percent (Iberia) of total airline costs. Variations in labor cost are partly attributable to differences in prevailing wage levels and labor market conditions in carriers’ home countries. Some countries, particularly the developing and newly industrialized countries in Asia, have significantly lower national wage levels. Airlines employing relatively cheaper labour can obtain significant cost advantages for labor intensive elements of operations. However, the ultimate cost of labor depends not only on wage levels but also on labor productivity. When measured by output per employee, labor productivity is affected by institutional factors such as number of work days per week, number of holidays, maximum duty periods

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50 Note that this total input cost does not consider "extra"-financing costs incurred by some financially troubled airlines, such as Canadian Airlines International, because of difficulty in compiling consistent data. As a result, total cost for such airlines is very likely underestimated.

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Figure 7.1 Airline Costs by Category 1995

Source: ICAO, Digest of Statistics
* 1993 data