

Roll with it

Industry consultant **Rudy Hemeleers** explains how rolling forecasts can help air cargo companies attain greater accountability in cost management

Air cargo management teams have an opportunity to integrate their cost and network profitability management processes and design a rolling forecast as the basis for a CEO management 'cockpit' to drive individual cost accountability through the organisation.

Successful cargo airlines, cargo divisions and airport handling companies have the right management control processes to continuously adapt the focus of their organisation to new market opportunities and competition – but very specific questions must be answered in the process.

For instance, airlines continue to invest in new, more efficient freighter

aircraft, but must look carefully at how best to utilise their freighter networks and identify the most profitable routes. Similarly, many airlines have introduced differentiation between individual cargo products and also offer customer-tailored solutions at higher yields. But what is the real cost of providing these additional levels of service?

The message from global shippers at the recent TIACA Air Cargo Forum in Calgary was clear: shippers want to discuss seasonal capacity allocations at competitive rates. Consequently, airlines must consider the total business of a customer within its network and identify the right contract rate for a strategic account. They must also pinpoint the real contribution of a par-

ticular customer to the bottom-line profitability of the airline.

Of course, many companies have defined key performance indicators (KPIs) to evaluate and reward their managers and employees. However, with market conditions and/or business priorities continuously changing, the targets set by an administrative and complex budget process can quickly become obsolete.

The challenge for CEOs is to create a communication channel that translates the changing business priorities into individual objectives with a limited number of correlated financial and non-financial numbers. Frontline managers must also be accountable for cost and profitability improvement.

Creating a 'cockpit'

Industry feedback to this consultancy suggests there is an understanding of the value of a new generation management information system to enable the right level of business insight and control. Such a system should:

- Provide an 'A4' overview of the business structured around a limited number of correlated financial and non-financial key performance indicators;
- Highlight unexpected variance between actual and expected results (with 'drill-down' to the underlying information at route, flight, shipment and customer detail);
- Provide accurate real-time business

September 7, 2006
Period: YTD August 06
Network: South-East Asia
Aircraft Type: B747-400F, MD11F
Customers: All

View results by route, aircraft-type, customer-segment

Front-line managers assume accountability for cost improvement and planning

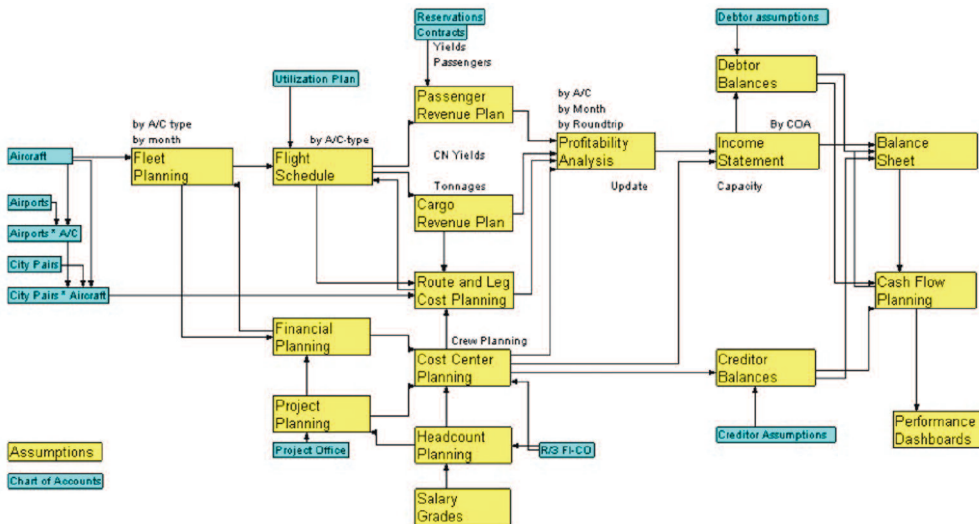
| | YTD Aug '06 | YTD Budget Aug '06 | Year-End Estimate | Year-End Budget | |
|----------------------------------|-------------|--------------------|-------------------|-----------------|----------------------------------|
| Net Revenues from operations | | | | | |
| Load Factor | 73% | 72% | 73% | 72% | VP Sales, Marketing |
| Tons flown | 23,783 | 23,315 | 33,656 | 29,972 | VP Sales |
| Average yield | 2.2% | 2.6% | 2.5% | 3.12% | Mgr Marketing |
| Commercial revenues | 60,884,201 | 62,483,757 | 87,169,763 | 93,511,873 | VP Sales |
| Commissions | 2,424,990 | 2,405,269 | 3,430,586 | 3,600,599 | Mgr Interline |
| | 58,459,211 | 60,078,488 | 83,738,177 | 89,911,074 | |
| Direct Operating Costs (DOC) | | | | | |
| Flight hours (block hours) | 6,065 | 6,039 | 9,084 | 9,059 | Director Flight Operations |
| Exchange rate \$/€ | 1.21 | 1.24 | 1.22 | 1.24 | Treasury Director |
| Fuel Price (\$/usg) | 1.61 | 1.50 | 1.89 | 1.50 | Director Ground Operations |
| Fuel | 21,897,744 | 20,732,081 | 38,981,733 | 31,098,121 | CFO, Director Fuel Mgmt |
| Direct maintenance costs | 433,093 | 402,613 | 634,399 | 603,920 | VP Maintenance |
| Direct crew cost per block | 221 | 200 | 226 | 200 | Director Crew Operations |
| Direct crew costs | 12,259,549 | 11,108,640 | 18,656,865 | 16,662,860 | Director Crew Operations |
| | 34,590,607 | 32,243,534 | 58,273,223 | 48,365,201 | |
| R1 Result after DOC | 23,868,604 | 27,834,954 | 25,464,954 | 41,545,873 | |
| Indirect Operating Costs (IOC) | | | | | |
| Aircraft financial costs | 7,511,243 | 7,447,200 | 11,234,843 | 11,170,800 | CFO, Director Financial Planning |
| Indirect maintenance costs | 10,386,691 | 9,885,000 | 15,566,731 | 14,828,400 | VP Maintenance |
| Indirect crew costs | 2,353,907 | 2,329,056 | 3,518,435 | 3,493,564 | Director Crew Operations |
| | 20,251,841 | 19,661,256 | 30,320,009 | 29,492,764 | |
| R2 Result after DOC | 3,616,763 | 8,173,698 | -4,855,055 | 12,053,089 | |
| Overhead | 1,392,465 | 950,700 | 2,085,615 | 1,426,050 | VP Administration |
| Operating Profit before expenses | 2,224,298 | 7,222,998 | -6,940,670 | 10,627,039 | |

Board room simulation capabilities

Credible year-end prediction

Typical income statement

A CEO management cockpit has a limited number of KPIs that are correlated through a driver based profitability analysis model



Airline management control blueprint

Hemeleers & Partners has developed an airline management blueprint linking financial and operational planning processes

insight without the requirement to maintain a factory of Excel spreadsheets;

- Include boardroom 'what-if' analysis and simulation capabilities to understand the sensitivity of network profitability to the most important revenue and cost drivers; and
- Extend the monthly reporting process with a top-down and bottom-up driver-based re-forecasting process that takes into account year-to-date actual results and the input of key frontline managers in contact with the day-to-day operation of the cargo business.

Importantly, advances in management information systems technology now enable financial planning and controlling divisions to integrate their reporting and planning processes in a stepped approach.

To this end, two points should be considered:

- First, get the 'actuals' right by integrating Excel spreadsheet factories into a single information system (or 'data mart'). We advise customers to use a multi-dimensional business modelling technology that can be configured and continuously improved by a team of business experts responsible for the key management control processes; and
- Second, simplify and integrate the business planning, budgeting and re-forecasting processes to a level of granularity that is appropriate for a communication process across the entire network.

Fortunately, technology has now

become sufficiently mature to build a management information system that can be introduced with just a small team of senior business controllers.

The air cargo management 'data mart' is structured around its most important component: network profitability analysis. As such, the multi-dimensional information data model allows managers to analyse the contribution of aircraft, routes, markets and customers to the profitability of the network. And by integrating several information sources, systems and processes, a good business model will have the right level of granularity to analyse the impact of a changing route structure, market segmentation, or flight structure.

Then, it is time to build a driver-based rolling forecast. After all, for an air cargo operator to be constantly capable of aligning its network capacity with local market demands, re-forecasts need to go beyond the finance function, be more frequent and involve key operational managers.

The classic budget and forecasting cycle focuses on the collecting projections on revenues and line item expenses. Operational managers are modelling the causal relationships that are running across their organisation. With this in mind, Hemeleers & Partners has created a generic rolling forecasting blueprint for the airline industry, including a step-by-step planning workflow enabling top-down and bottom-up re-forecasting of route profitability, financial statements and year-end cash flow.

Fleet and flight planning modules include the most recent capacity planning on a route basis and, as such, integrate the key information required for cargo revenue planning. Using forecast load factors, the driver-based model then estimates sales-related costs (such as agent and GSA commissions and interline fees), cargo volume-related costs (such as airport handling and trucking costs) and the direct and indirect flight-related operating costs.

A further extension of the model will provide the financial intelligence to calculate pro forma financial statements up to the level of monthly cash flow planning.

Such a driver-based rolling forecast offers a variety of business benefits. First, it simplifies the budgeting, planning and re-forecasting processes resulting in a more frequent update of the forecast, so enabling managers to assess the impact of alternative business scenarios. It also ensures that a business model is shared through the organisation while an improvement in the credibility of predictive planning information is also provided for board members and financial investors. ■

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