

- Airlines have moderately high financial leverage, implying that a drop in revenues can result in a major cash flow shortage.

- As airlines switch from owning to leasing their aircraft, their finances are changing from strong cash generators to a position where cash in-flows and out-flows must be closely balanced. This is because leases tend to be for a larger proportion of the value of the aircraft than the debt portion in the case of internally financed equipment. This could be lessening the ability of carriers to sustain a recession in this procyclical industry.

#### A. Measuring Carrier Cost Competitiveness

A simple, common approach to assessing a carrier's cost is to sum up its total expenditures and divide this by the number of passengers or passenger kilometres of service provided.<sup>44</sup> This average cost measure is then compared between carriers. However, while easy to calculate and often used, it can be misleading.

Among the items which are most significant in accounting for differences in airline costs are those listed in Table V. A comparison between carriers on any one of these items might be made, but it would not necessarily be meaningful. For example, one carrier might be found to have higher wage costs than another carrier. Does this mean

<sup>44</sup> In the airline industry, simply measuring the number of passengers who are served by a carrier is generally considered an insufficient measure of the service provided. This is because some airlines carry passengers for short distances while others carry them for very long distances. Instead, the industry uses the *passenger kilometre*, which sums up the number of kilometres each passenger is carried. Thus, a flight with 100 passengers for a distance of 500 kilometres is measured as having produced 50,000 passenger kilometres. Since some passengers on a flight will not have paid a fare for the service (for example, airline employees, frequent flyer award seats, etc.), the industry distinguishes between total passenger kilometres and revenue passenger kilometres. The latter is generally the measure of service which is used.