This edition of Transport Perspectives focuses on two highly topical issues in the transport sector.

In the first article, Charlie Simpson and Tom Dale examine customer experience transformation within the transport sector. In the second article, Tom Woods discusses growth drivers in the aviation leasing marketplace.
Transforming customer experience in transport

Mining customer data for insight and value
Transport companies have for years been investing in customer research data, segmentation and analytics in an attempt to understand customers better and improve customer experience. As early as 1994 British Airways understood clearly that customers who flew by Concorde divided into at least seven distinct groups, each with subtly different, and potentially incompatible, customer service expectations1. More recently the company has seen significant success from an end-to-end data exploitation programme focused on its leisure customers: in the key segments targeted growth has been as high as 20%2.

Data analysis is equally important in the low cost or budget transport market. For example Stagecoach, operators of the budget inter-city service Megabus, state that: “[while] value fares are the price driver in ... growth ... we actually think there is some market segmentation there as well3.” Careful consideration of variable willingness to pay has been central to their successful Stagecoach Gold ‘affordable luxury’ service: first trialled in 2007, it now covers 14 routes across the UK with an order of 38 new buses announced this March4.

Transport sector investment in customer experience is accelerating
Though the principle of investing in customer experience is nothing new, in recent years activity in the transport sector has seen a marked increase, with three key drivers underpinning the trend:

» Customer expectations are rising
Technology and digital experience of how customers interact with clients are driving higher customer expectations. A key example of this is the consumer trend of personalisation and tailored customer information. A recent global study by IBM found that, of 21,000 customers surveyed, 90% were willing to spend up to 20 minutes uploading preferences in a mobile app, so the company could personalise the experience for them. In contrast, only 32% of companies surveyed actually had this capability5.

1 Interview with BA’s then Marketing Director Peter Liney: https://www.youtube.com/watch?v=02nYo6LEYQ
2 Case study by Black Sun Marketing: www.blacksunmarketing.co.uk
3 Coach operators seek new avenues of growth, Financial Times, 05 June 2012: http://www.ft.com/cms/s/0/6b17832e-abdd-11e1-a8a0-00144feabdc0.html#axzz332c5GkV
UK rail franchising improvement trajectories

The charts below show the significant improvement in customer experience required for rail franchises recently mandated by the DfT.

**Essex Thameside**

- **61%** Customer services
- **10%** Trains
- **29%** Stations

**InterCity East Coast**

- **41%** Customer services
- **33%** Trains
- **26%** Stations

**Thameslink, Southern and Great Northern**

- **35%** Customer services
- **35%** Trains
- **30%** Stations

**Competition for customers is increasing**

In recent years, increased competition through customer segmentation has been striking, particularly in the ‘low-cost plus’ airline space. For example, since 2010 easyJet has seen a 44% increase in business travellers through initiatives such as flexible booking, allocated seating and closer partnership with corporate clients and their travel management companies. Each of these initiatives has been delivered on the basis that operating cost increases over other purely low-cost rivals would deliver sufficiently valued customer improvements to allow effective competition with legacy carriers.

**Public procurement is also seeking customer experience transformation**

Against this background of consumer trends, public transport authorities have made it clear that they also wish to procure "investment in innovative ways to transform the customer experience." For the UK’s Department for Transport (DfT) customer experience is a key priority. Since last September’s recommencement of UK rail franchising, KPMG analysis of the contractually-mandated improvement trajectories for the three DfT-controlled franchises so far put out to tender shows a clear dominance of customer service factors. Even in the Thameslink, Southern and Great Northern (TSGN) franchise, where nearly 1,400 extra carriages are due to be supplied by the end of 2018, customer service and train factors still rank equal first.

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Source:

KPMG analysis of DfT Franchise Agreement improvement trajectories

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Keys to success
Driven by these factors, growth in transport customer experience investment looks set to continue. With market players seeking bolder and more ambitious moves to outflank their competition, it is becoming increasingly important to identify keys to success and manage the associated risk:

» Engaging customers emotionally
Recent research by transport consumer body Passenger Focus identifies the emotional aspect of travel as a key future development area\(^10\). Best practice from outside transport focuses on building loyalty through deepened engagement with a company’s brand. This is achieved through new digital technologies that increase the richness of customer interaction, and by building these into the physical retail environment for a true omnichannel experience.

This approach has been central to John Lewis’s successful omnichannel customer strategy story\(^11\), and also to more recent examples such as clothing brand Hollister’s live streaming of Californian beach footage to giant video walls in 50 of its stores across the USA\(^12\). Designing customer experience around engagement can also be done at low cost. Successful last-minute booking app Hotel Tonight boosts memorability by having users confirm payment by tracing the shape of the company’s distinctive bed-shaped logo on their smart phone’s touch screen\(^13\).

» Engaging the customer-facing workforce
Customer-facing staff in transport are seeing major and long-term impacts from technological change, one of the most visible examples being Transport for London’s removal of 897 ticket office roles, primarily as a result of introducing the Oyster Pay As You Go smart card system\(^14\). An important lesson from retail is that as technology helps inform and empower customers, they in turn come to expect even more from the face-to-face encounters they do have. The key challenge is that, while customer expectations regarding staff are rising, service sector staff engagement is low and falling: according to Gallup’s latest survey\(^15\) 70% are actively disengaged.

For companies seeking to improve customer experience through staff engagement one clear key to success has been a comprehensive philosophy of staff empowerment: this has been central to success stories such as First Direct in financial services\(^16\), Marriott and Ritz Carlton in hospitality and retail examples such as Nordstrom\(^17\) and Zappos\(^18\). Ritz Carlton, as their former CEO explains, entrust every single staff member, without approval, to spend up to US$2,000 on a guest: “It doesn’t get used much, but it displays a deep trust in our staff’s judgment. ... The concept is to do something, to create an absolutely wonderful stay for a guest. Significantly, there is no assumption that it’s because there is a problem. ... A lot of the stuff that crosses my desk is ... that they used their US$2,000 to create an outstanding experience\(^19\).”
Ensuring transformational investment has a sound analytical base

Embracing more ambitious and transformational investment has been the approach adopted by a large number of firms, from UK retailer Argos,20 to breakdown provider AA (the Automobile Association). Digital transformation of customer experience is a key strategy for AA. Success so far includes a new homepage with clear focus on customer journeys and sales, new social media presence with transformed tone of voice to improve customer engagement and a suite of new mobile apps.

For any firm in this position the key to success is ensuring new initiatives have a sound analytical base. A cautionary tale is that of American Express Consumer Travel, whose customer strategy successfully delivered increased satisfaction, but without corresponding growth in revenue. Investigation revealed the company “had amassed a long and unwieldy checklist of required frontline rep actions. Reps spent call time ticking off boxes rather than listening to customers’ needs.”21 Although customer satisfaction rose, revenue turned out to be much more influenced by easy service. With “Net Easy” scores now firmly embedded in the business, the company has successfully rectified this problem.

Conclusion – the need for customer experience transformation

Taking stock across the sector, successful passenger transport companies are frequently large and complex, dominated by engineering and the ever present demands of safety, operational performance and robust cost control to retain profit against stiff competition. Today, however, and for the foreseeable future, transforming customer experience is central to winning new journeys that are made by choice, and improving satisfaction with those made out of necessity.

To stay successful, transport companies of tomorrow need to ensure customer strategy is not simply a marketing overlay or left to niche players and start-ups, but right at the heart of their strategic investment and business design.

10 http://www.passengerfocus.org.uk/key-issues/future-of-transport/five-future-stories#Eight
12 http://www.stockteam.com/hbpress54.html
13 https://www.hoteltonight.com/
16 http://www.businessstore.co.uk/Blog/View/Articledetail/component/get-articledetailclass-example-customer-delight
17 http://www.consumerist.com/2010/10/24/nordstroms-old-employee-handbook-had-only-75-words
20 http://www.argos.co.uk/static/ArgosPromo3/includeName/old-street.htm
Airline leasing
Up in the air?

The growth in aviation leasing has been extraordinary since its genesis in the mid 1970s. Today the number of leased passenger aircraft stands at just under 40% of total passenger fleet in service (approximately 7,000 out of 18,000)\(^1\). The rate of growth in the past few years has been particularly steep with deliveries of aircraft to lessors in excess of 40%. Airbus confirmed that deliveries of aircraft to lessors in 2013 accounted for 44% of total aircraft deliveries in that year\(^2\). Though the percentage of leased aircraft is expected to grow further, with some analysts suggesting it could touch 50% by the middle of the next decade\(^3\).

So why are leased aircrafts being used more?
The reasons for leasing aircraft vary and range from:
1) Airlines diversifying their financing sources
2) Airlines having difficulty accessing finance
3) Airlines having difficulty accessing aircraft when they need them
4) Reducing exposure to residual value

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\(^1\) Ascend Aircraft Investment Index, A Flightglobal Advisory Service, page 1, ascendworldwide.com last accessed 20/08/2014
\(^3\) Avolon 2013 World Fleet Forecast; Dick Forsberg (June 2013), page 5
Access to capital and diversification of finance
Financially strong carriers with access to capital use lessors to diversify their financing sources to manage their overall credit exposure. Those who have weaker credit and struggle to access capital, use lessors as a financing source.

The global economic downturn saw lessors continue to perform well and provided resilience to the industry as a whole. The ability of lessors to access credit, due to strong balance sheets, parental support and well diversified portfolios is an important reason as to why lessors will continue to provide proportionately more finance to the airlines in the future.

Flexible matching of supply and demand
Carriers also often need aircraft at times when they have no delivery slots themselves. They look to lessors to help them meet the demand. The last few years have also seen the broadening of aircraft types offered by lessors. The single aisle 737s and A320s have and continue to account for most installed fleets (in fact expected to increase to circa 70% over the next 20 years). They are the most attractive and liquid of assets for lessors due to their ability to remarket these aircraft to most airlines without significant transitioning costs. However, there is a trend in upsizing aircraft - we have seen demand move from, for example, A319’s to A320’s to now A321’s.

More recently lessors have increased their exposure to twin aisle aircraft and one recently established lessor, Amedeo, is specialising in the extra wide body A380. Twin aisle aircraft are a much bigger investment for lessors. They need to be carefully managed as they are a less liquid asset (currently) and the transitioning costs on a re-lease to a different airline can be much more significant than a single aisle. The rental yields, however, are much higher to compensate for this and we have seen more investor interest in these assets.

There has also been an increased lessor focus on turboprop aircraft, helicopters and more recently business jets. Lessors are also differentiating themselves in the age of aircraft they focus on, whether they are new, midlife or old aircraft. This is offering airlines many more leasing solutions for their aircraft demands.
Exposure to residual value
The economic useful life of aircraft and the appropriateness of depreciating passenger aircraft down to a 15% residual over 25 years is a much discussed topic. The introduction of new technology, more fuel efficient aircraft, and age restrictions in certain countries has created uncertainty about the useful economic life of an aircraft. Airlines have and will always look at ways to manage their exposure to residual value and the attraction of using lessors is that it crosses both the strong and weaker airlines and has the ability to remove residual value risk from their balance sheets.

Leasing: a key pillar to future aircraft financing
To put the use of lessors in the future into context, the financing requirement for new aircraft over the next 20 years is estimated at US$4.4 – US$4.8 trillion averaging at about US$100 to US$120 billion per year for the next ten years. Broadly, Boeing and Airbus forecast an additional 29,000 to 36,000 aircraft entering service over the 20 year period. Given the enormous financing requirements and the proven ability of lessors to fund aircraft in good and bad times, we expect the demand for leased aircraft to increase in terms of both the absolute number of aircraft leased and the relative proportion of leased versus owned aircraft.

Search of yield
The low interest rate environment has driven investors to alternative asset classes in search of yield. With steady predictable cash flow generated from leased aircraft assets over a long period, this asset class has garnered considerable interest over the last number of years, more asset backed securitisations in the marketplace.

Access to finance
The debt and equity markets opening up to the aviation sector is enabling lessors to raise funds directly in the market with the percentage of funds drawn by lessors from the capital markets rising from 9% in 2012 to 40% in the current year. A growing number of lessors also have banks as parents (mainly Japanese, Chinese, Russian, and US). This financial relationship can provide these lessors with access to cheap credit and is likely to place lessors generally in a good position to fund the future aircraft demands of airlines.

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Captive assets

In addition to the number of lessors that have established to serve the airlines, a number of airlines have placed significant aircraft orders in their own right sometimes establishing captive leasing companies to manage these assets. Some of the legacy carriers already do this, but an increasing number of the low cost carriers establish captive leasing companies to manage the costs associated with the aircraft (including FX fluctuation).

We believe that airlines with access to finance will follow this model or a variation of the model (joint ventures with lessors/financiers) as the savings can be substantial. Regardless of the structure used however, it is clear that leasing will continue to play an ever more important role in the financing of aircraft over the next 20 years.
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