

# State of the MRO Industry 2009: Competitive Shifts and Curtailed Growth

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With a decrease in the installed base and in future growth rates, players in the aviation maintenance, repair, and overhaul (MRO) industry are being forced to rethink their strategies. Original equipment manufacturers (OEMs) looking to replace lost margin from aircraft cancellations are accelerating their focus on the aftermarket, which in turn is causing independent MRO providers to adapt their positions in the market.

To explore the impact of the current economic situation on the aviation MRO market, Oliver Wyman recently surveyed over 230 airline, airline MRO, independent MRO, and OEM executives. Respondents represented a global mix of mainline, low-cost carrier (LCC), regional, and mixed-format carriers. Respondents came from businesses of all sizes, from less than \$50 million to over \$2 billion in revenues.



## Highlights of the Study

- The MRO market will shrink in 2009, but then resume growth at slower rates.
- Outsourcing of MRO activities, while significant, has leveled off.
- Airlines continue focus on Total Maintenance Support as the most important factor in selecting an MRO provider.
- Half of MRO and OEM respondents believe OEMs are gaining competitive advantage relative to MROs in the aftermarket space, and these OEMs are more confident of their competitive advantage than MROs.

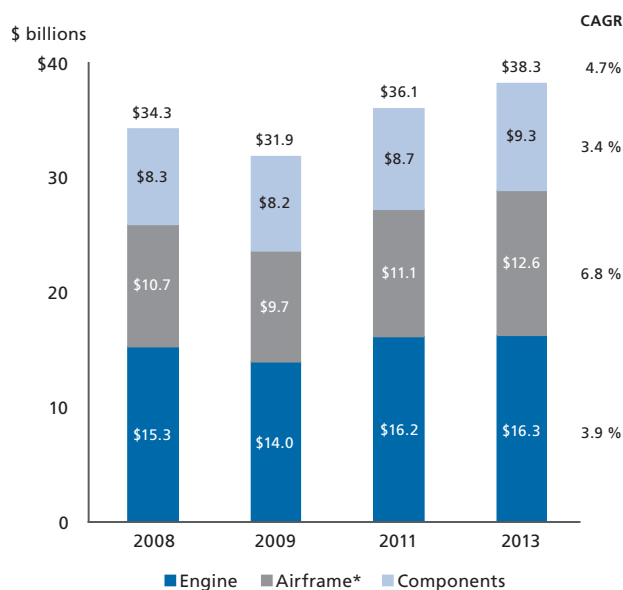
### MRO Market Growing after 2009, but at Slower Rates than Previously Anticipated; Outsourcing Levels Off

Through 2008, with fuel prices reaching historic highs and demand faltering, airlines, particularly North American carriers, were forced to significantly reduce capacity and to sideline an unprecedented number of aircraft. With optimism around a quick economic recovery waning and loads softening across most markets, further capacity reductions are likely.

As a result of this contraction, the global MRO market is forecast to shrink by \$2.4 billion, or 7%, in 2009. Beyond 2009, the market is anticipated to remain challenging; Oliver Wyman predicts that the industry will achieve a 4.7% compound annual growth rate from the end of 2009 through 2013.

In the airframe market, capacity cuts have produced a one-time reduction in mature airframe maintenance; however, legacy aircraft will still drive significant airframe spend. Similarly in the engine category, capacity reductions will reduce mature engine maintenance demand, but legacy fleets will still drive overhaul and Life Limited Parts spend, which make up over 85% of the total engine maintenance market in 2013. Although components spend will be insulated from capac-

Exhibit 1 Maintenance spend forecast



Note: Spend is trade-flow-adjusted.

\* Includes modifications.

Source: Back Aviation Database, Oliver Wyman analysis

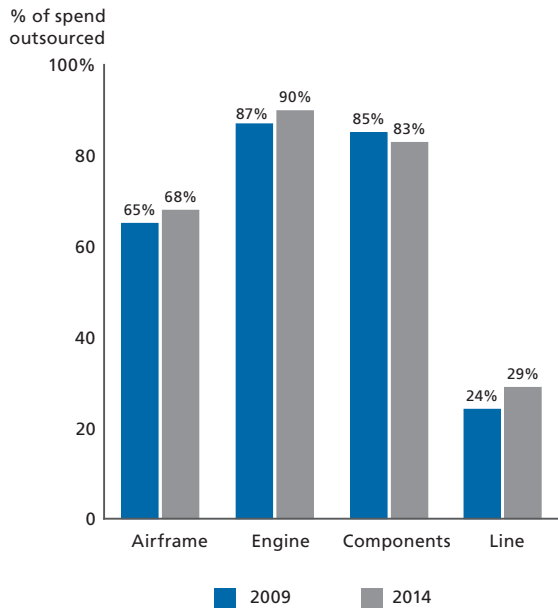
ity cuts because higher-tech parts require greater maintenance, the category will see slower growth overall than other maintenance categories. When compared to consensus forecasts from 18 months ago, 2013 industry revenue forecasts are down by \$5 billion (Exhibit 1).

Outsourcing growth has been slowing and will continue to do so. Only line maintenance is expected to have a sizeable increase in outsourcing over the next three years (Exhibit 2). Many carriers have reached the limits in achieving cost savings through outsourcing maintenance, particularly in engines and components. Carriers are now focused on performance improvement to control costs, both within their own maintenance organizations as well as in partnership with their maintenance providers.

### Airlines Demand Total Maintenance Programs and Seek More Advanced Material Solutions

Although quality, turn times, and low costs continue to be the key drivers in maintenance provider selection, a Total Maintenance Program has also become a major selection criterion (Exhibit 3). Carriers continue to shift risk and responsibility to

## Exhibit 2 MRO outsourcing by area



Source: Oliver Wyman

their MRO providers, and increasingly value a provider that will provide more than just qualified labor. For an increasing number of airlines, the demand for total MRO solutions has expanded. Many carriers are now in the process of, or considering, outsourcing broader engineering and maintenance program ser-

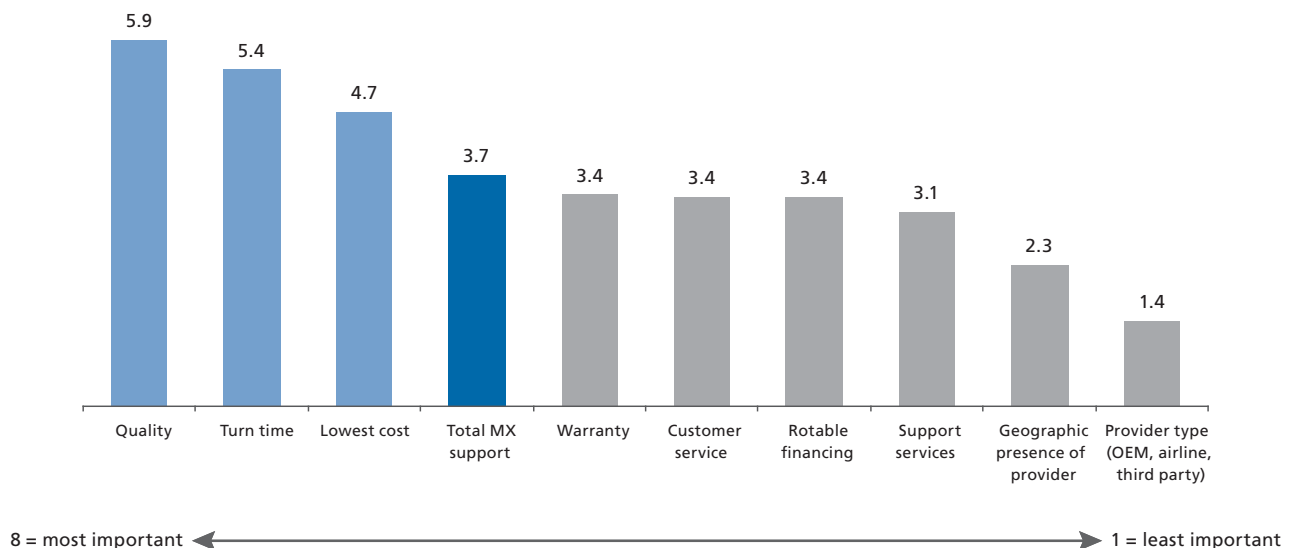
vices. Successful providers will need to find creative ways to integrate these services into their more traditional maintenance offerings.

Components rotatable financing is also finding its way onto the MRO agenda. Survey results show this service to be the most important selection criterion for European carriers other than the usual criteria of quality, turn times, and cost. Contrary to historical trends, North American airlines are also increasingly looking at their component inventories as an asset that can be tapped for cash and more effectively managed by a third party. Rotable/repairable component inventories typically represent several hundred million dollars in value for a global airline. In fact, the largest airlines can carry as much as \$700 million in rotatable/repairable inventory. Significant efficiencies can be found in managing these pools more effectively, and they also represent an opportunity to create liquidity.

Pure financial plays such as sale-leasebacks have proven expensive and unattractive for many carriers. However, programs that integrate rotatable pooling, rotatable inventory optimization, configuration management, component repair, and component financing can dramatically improve total costs compared to less integrated solutions.

## Exhibit 3 Overall supplier selection criteria

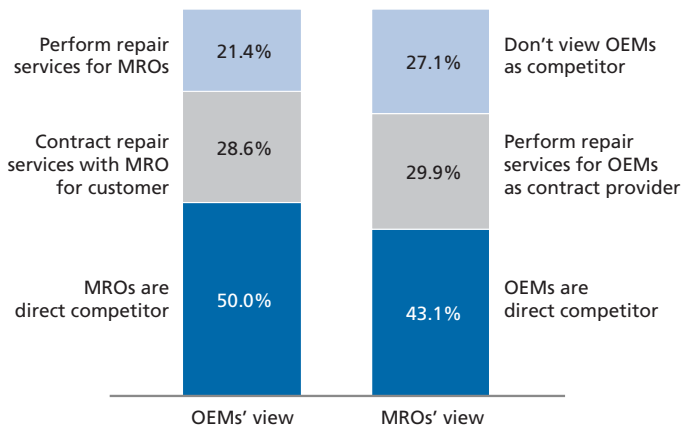
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Source: Oliver Wyman

#### Exhibit 4 Competitors' view of competition

Which of the following best describes the current relationship your company has with OEMs/MROs?



Source: Oliver Wyman

#### OEMs Confident in Their Aftermarket Abilities; as a Result, MROs Evolving

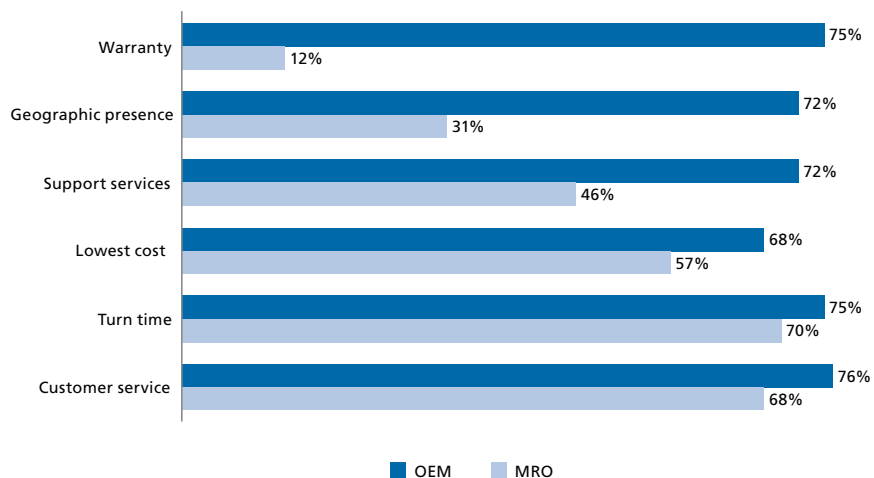
The Oliver Wyman survey reveals an increasingly complex relationship between OEMs and MROs, one where the balance between partner and competitor is constantly changing. Survey results highlight that nearly 43% of MROs and 50% of OEMs view each other as competitors; however, the remaining 57% and 50% of MROs and OEMs, respectively, see their counterparts as either customers or partners (Exhibit 4).

The relationship between OEMs and MROs has evolved over the years. The traditional OEM focus was on growing the installed base of products, ensuring an annuity of aftermarket parts sales. Little focus was placed on broader services, which were typically provided by airlines themselves and later by a broader MRO community as airlines looked to outsource large aspects of their maintenance operations. Airlines embraced the independence of MRO providers as a true alternative to OEMs, which catalyzed an exponential growth in MRO revenue from 2000 to 2005.

Seeing this growth as a new revenue opportunity, in addition to recognizing the risk of disintermediation of their customer relationships, OEMs devoted more effort to the aftermarket. This began first with engine OEMs, continued several years later with component manufacturers, and in recent years has caught the interest of aircraft manufacturers. What were once relatively clear lines have blurred, with OEMs now using MROs for fulfillment, as well as competing with them directly in the aftermarket.

In addition, OEMs are more confident in their abilities relative to MRO providers. When asked if their company has a competitive advantage across a number of attributes compared with MROs, the overwhelming majority of OEMs stated that they have the advantage across all attributes (Exhibit 5). In contrast, when

#### Exhibit 5 Percentage of respondents stating their company has a competitive advantage



Source: Oliver Wyman

MRO providers were asked the same question relative to OEMs, over half of the MROs responded that OEMs have the advantage when it comes to warranty, geographic presence, and support services. And with respect to turn times, customer service, and lowest costs, MROs were less confident than OEMs in their competitive advantage.

### MROs More Aggressive in Changing Their Business Models

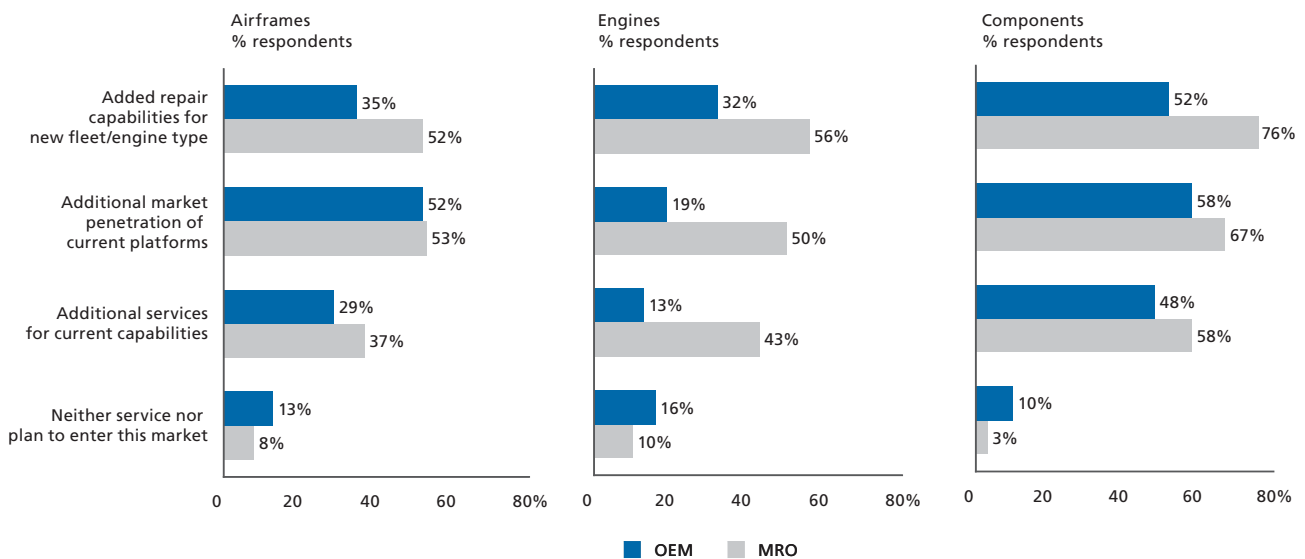
As a result of these competitive pressures both within the MRO community as well as due to the influx of OEMs as competitors in the aftermarket space, MROs are being forced to act more quickly and more aggressively than OEMs. When asked about their plans for growth, MROs had significantly more aggressive responses than OEMs. Well over half of all MRO respondents plan to grow by adding repair capabilities for new fleet/engine types and increasing penetration of their current platforms (Exhibit 6).

In addition to their plans for future capabilities, MROs also saw a more pressing need to evolve their business designs. Some 52% of MROs plan to fit the full-service integrator model by 2012, with only 29% of OEMs planning the same. The increased activity of OEMs in the aftermarket has forced MROs to evaluate how they can most effectively compete, and this migration in business design is a clear step in this direction.

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Reduced market growth, leveling off of outsourcing, and the rise of OEMs in the aftermarket has intensified the competitive pressure in the MRO market. To succeed, all of the players will need to critically evaluate the effectiveness and relevancy of their current strategies and business designs. ❖

Exhibit 6 Plans for growth



Source: Oliver Wyman

## About Oliver Wyman

With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC].

## The Aviation, Aerospace & Defense Practice

Oliver Wyman has deep, international experience in all segments of aviation, including airports, airlines, service providers, MROs, OEMs, and investors. The Aviation, Aerospace & Defense Practice has consulted to nearly three-quarters of the Fortune 500 firms in these sectors, as well as to major airports around the world.

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