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Dawna L. Rhoades
Embry-Riddle Aeronautical University, rhoadesd@erau.edu

Tamilla Curtis
Embry-Riddle Aeronautical University, curtist@erau.edu

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Chapter 16

The Challenge of Intervention to Monetarily Support or Not Support the National Airline Carriers: A Case of the Airline Industry in Eastern Europe

Dawna L. Rhoades
Tamilla Curtis

ABSTRACT
The airline industry has been considered a special case in national and international business virtually since its beginning. Because of this status, national governments have repeatedly intervened to support national carriers in order to prevent bankruptcy and failure. The nations of Eastern Europe are no exception to this rule and are currently considering additional intervention to support their carriers. This paper explores the rationale for intervention, particularly the suggested economic impact, using traffic and financial information from the *Flightglobal* database. The conclusion is that the case for intervention is weak at best and that the results may not justify the expense.

INTRODUCTION
The air transport industry is classified by economists as cyclical, meaning that it is sensitive to the business cycle and a leading indicator for the health of the general economy. Demand for air transport services – passenger and cargo – is closely linked to the state of the economy (Taneja, 2003). The first segment of this industry to experience a downturn is normally air cargo, followed closely by passenger transport. As the air cargo industry entered the last quarter of 2011, carrier and analyst forecasts began to take a turn for the worse. European airlines such as Finnair and Lufthansa have followed suit and warned of lower profit expectations going into 2012 (Flottau & Wall, 2011). Because of this sensitivity to the business cycle, the airline industry is no stranger to economic trouble.

Unlike many other industries, national governments have considered aviation a special case in domestic and international business. This 'special' status is based on three arguments – national defence/security, economic impact, and national pride. The aviation/aerospace industry is used in many countries as an adjunct to military logistics as well as contributing high value technology. This military role is most obvious in the US military's use of civilian aircraft to deploy troops to theatres of operation overseas. Aviation/aerospace also contributes to economic growth and development. In 2010, global airlines carried over 2.4 billion passengers and directly employed over 5.5 million people with another 27.5 million employed indirectly in aviation and related tourism. The Air Transport Action Group has estimated that aviation generates roughly $425 billion of GDP per year and has

predicted that the contribution in 2026 could be as high as $1 trillion (Air Transport Action Group, 2011). The final reason for special status is quite simply national pride and governments find it difficult to accept the loss of a national 'flag' carrier (Rhoades, 2008).

Even with the rate of air travel in Eastern Europe growing at about twice the rate for Western Europe, the government owned carriers in this region continue to struggle to reach and/or sustain profitability. Commonly cited reasons for these struggles have been the failure of these traditional carriers to revise their structures, update their technology, and adopt the standards and innovations that are propelling their competitors in the airline industry. Not only are these carriers posting annual losses, but the governments are being asked to inject additional funds into these carriers to help them survive (Flottau, 2011).

This paper examines the economic impact of national carriers in Eastern Europe, and explores whether government financial assistance is the 'solution' to maintaining a sufficient transport infrastructure and aviation access for the citizens of these countries.

EASTERN EUROPE

The United Nations classifies the following 10 countries under the Eastern Europe geographical region: Belarus, Bulgaria, Czech Republic, Hungary, Poland, Republic of Moldova, Romania, Russian Federation, Slovakia, and Ukraine (UN Statistics Division, 2011). This study included a total of 7 countries under the investigation based on the Flottau (2011) research, additionally including Latvia.

Table 1 presents the overall statistics for the seven select countries under study, including the total number of airports and the value of annual tourism since the contribution to tourism is often cited as an economic contribution of aviation. Still, it is difficult to determine how much contribution national carriers actually make to this total since many tourists will travel to their destination on their own home country carriers as well as other modes of transportation. The largest country under study in terms of population is Poland with approximately 38 million and 86 paved airports, and the smallest country is Latvia with approximately 2 million population and 19 paved airports.

Table 1: Overview of Countries

	Poland	Romania	Czech Republic	Hungary	Bulgaria	Slovakia	Latvia
Population	38,415,284	21,848,504	10,177,300	9,958,453	7,037,935	5,483,088	2,191,580
Capital	Warsaw	Bucharest	Prague	Budapest	Sofia	Bratislava	Riga
GDP / capita	$20,100	$12,300	$25,900	$19,600	$13,500	$23,400	$15,400
Labour force	17.93M	9.252M	5.269M	4.274M	2.533M	2.713M	1.169M
Public Debt/GDP	56.70%	38.60%	40.70%	82.60%	17.50%	43.40%	44.80%
Airports (paved)	86	26	44	22	130	20	19
Annual Tourism	$11,229.3M	$954.3M	$6,177.2M	$5,988.7M	$3,289.3M	1,298M	$735.4M

Source: CIA Factbook, https://www.cia.gov/library/publications/the-world-factbook/ as of March, 2012. Tourism data from http://www.euromonitor.com/countries

ECONOMIC CASE FOR AIRLINES

One of the strongest arguments for the protection and support of airlines has always been the economic impact that their loss might cause. Direct losses can include lost airline jobs, lost cargo capacity, lost tourism, and consumer losses due to higher ticket prices. There can also be indirect costs that might result from the indirect employment losses of suppliers and other supporting industries or segments of the aviation industry. These indirect costs include negative effects at airports, lost economic development as prospective businesses choose locations with better international connections, and even the inconvenience to citizens of connecting through cities outside the nation (Rhoades, 2008). A study conducted in Kansas (USA) on the financial impact of a single new, low cost carrier in the Wichita area estimated that investment in the carrier returned $3.64 for every $1 invested. The study estimated costs and benefits in three areas –business activity and employment, airport activity and spending, and decreased ticket prices due to additional competition (Harrah & Jolly, 2008). Given such estimated returns from the presence of a single carrier, it is not surprising that nations are particularly inclined to offer support when the airline is the national carrier of their country and figuratively carries their flag around the world.

Still, the question remains whether the potential losses justify the government support provided to national carriers, many of whom are historically unprofitable. The Hungarian national carrier Malev is a case in point. The carrier which had begun replacing its Russian fleet of aircraft in 1988 was owned by the Hungarian state property agency APV until 2007 when it was privatized to AirBridge Zrt, a Russian-based consortium, and joined the Oneworld global alliance. In 2009, a 49 percent stake was sold to the Russian company, Vneshekonombank, and Russia's Aeroflot Airlines was expected to assume management control (Malev, 2011). The carrier was renationalized in 2010 after private shareholders refused to continue to support airline losses, estimated to be $125 million for that year. The Hungarian government now owns 95 percent of the carrier with AirBridge retaining the remaining 5 percent. The equity of Vneshekonombank was converted to debt, making it the largest creditor. In 2011, the Hungarian government made three contributions to the struggling carrier ($13 million in April, $23 million in June, and $94 million in September) for a total of $130 million (Flottau, 2011). The European Commission announced an investigation of the subsidies into Malev in December 2010 and it now appears that the opinion of the Commission will be negative. If this is the case, then the Hungarian government could be forced to reclaim funds from Malev, a move that could jeopardize the future of the carrier (Kaminski-Morrow, 2010).

Even if the government actions in this case and other Eastern European countries are allowed to stand, the question remains whether they are justified. Will they result in a revived and viable airline? Will carriers make the investments and changes

necessary to compete? Would national governments be better advised to use these funds in other ways? Again, the economic case for intervention suggests that the failure of a national carrier will be the catalyst for a host of negative economic consequences resulting directly from industry-related employment and reduced competition and indirectly from lost future development. The following section will attempt to present a preliminary answer to these questions through the review of data on the aviation/aerospace sector.

METHODOLOGY

This study investigated National Airlines of seven Eastern European countries based on the United Nations classification and Flottau (2011) research, additionally including Latvia (see Table 1). Newly formed countries after the dissolution of the USSR such as Belarus, Republic of Moldova, and Ukraine as well as Russian Federation were excluded from this study.

Data for Eastern European airlines and airports was collected from the *Flightglobal* database (formerly Air Transport Intelligence), one of the leading sources of information on the global air transport. Flightglobal is available to subscribing members which includes the Jack Hunt Library of Embry-Riddle Aeronautical University. Available data includes information from Reed Business Information's Flightglobal as well as aircraft/fleet statistics, airline routes, ownership, financial and traffic results, and personnel information.

FINDINGS

Airports

Table 2 in the Appendix presents a 5-year history of the major airports in these seven countries, including the number of domestic and international passengers carried, and the contribution to international and domestic cargo. While this is not an exhaustive list, it does include the major international airports for passenger and cargo arrivals. As this data shows, there is very little domestic cargo transported by air through any of these airports and limited international cargo outside the national (capital) hub airport. The international air cargo figures presented include cargo from all sources – scheduled passenger airlines (including the national carriers) and all cargo operations (including air freight forwarders and the integrated logistics companies such as UPS and FedEx). In fact, cargo revenue (domestic and international) contributes less than 4 percent of total revenue for any of the select national carriers (see Table 3 in Appendix).

Airlines

Additional information on the national or flag carriers of each country is presented in Table 4 (see Appendix). Note that all these except Bulgaria Air have majority government ownership. Further, all display the sort of inconsistent financial performance that is characteristic of the economically sensitive airline industry. Out of seven countries under the investigation, two flag carriers (Malev and Slovak Airlines) ceased their operation in February 2012 and January 2007 accordingly due

to financial problems. Another airline airBaltic was renationalized in December 2011 by Latvian Government to avoid the bankruptcy. Reducing costs enables carriers to lower prices in the face of declining demand and/or competition from low cost carriers (De La Merced, 2011).

The failure of any of these national carriers would have relatively little impact on domestic passenger travel with the exception of Poland (see Table 3). There might be impacts to international travel, but non-national carriers would likely have additional capacity that could be utilized. The total direct workforce for these carriers generally does not exceed 2,500. Using the 5 to 1 ratio of direct to indirect employment used by the trade association, Air Transport Action Group, the total employment effect would be roughly 12,500.

At this stage, the questions that national carriers face are whether the overall yield on domestic routes is greater than other routes served, and/or could traffic from these routes increase the overall flow to their network. In many cases, non-national carriers would seek to flow traffic over their hubs for the sake of efficiency which would result in fewer direct flights for the citizens of certain countries.

DISCUSSION

Although air traffic has been constantly increasing in Europe, Eastern European flag carriers are struggling to compete with private airlines, including low cost carriers. As a result, these flag carriers have continued to ask for government assistance. The case of government involvement in the airline industry has traditionally been based on three reasons: national defence, economic impact, and national pride.

Unlike the United States, which has used its civilian fleet extensively to move troops and supplies to distant nations, most other countries do not engage in the rapid deployment of large numbers of troops and so this argument would not seem to apply. The last argument, national pride, is not open to logical argument, but tends to centre on fears that a foreign carrier will not serve the local population as well as 'one of our own'. This leaves economic impact as the rationale for government intervention, financial and otherwise.

Arguments for economic impact typically look at employment, airport activity, local business activity, and ticket price. The carriers examined in this paper have little direct employment. For example, LOT in 2010 had approximately 3,500 employees. If we assumed an indirect employment rate of 3 to 1, then there is an additional 10,500 potentially impacted employees. Whether the closure of LOT would actually result in the complete loss of these indirect jobs is a question of debate as many of the suppliers would have other customers. Still, indirect employment is a consideration. Airports can be small cities unto themselves with their own police and fire service. They also have landside operations that can range from mini shopping malls inside the airport to related and unrelated activities on airport property such as warehouses, golf courses, hotels, rental car services, and personal store units. In other words, airports operate a wide range of business activities

consistent with the main airport operations. Some of these activities could be impacted by the loss of a single air carrier, particularly a large, single carrier. One example is airport shopping that might be reduced if fewer passengers flow through and around the airport due to reduced flight activity. Other activities such as golf courses are not likely to experience impact. Estimating the magnitude of these airport-related impacts will vary by airport location but have been done in a number of instances such as the Kansas example cited above. Similarly, the impact to local business activity will also vary by location.

Both of these cases also vary depending on whether you assume that the lost activity from the national, government owned airline will not be replaced by either another local operator or a foreign carrier. It is certainly possible that the capacity freed up at an airport by the demise of a national carrier – ticket counters, landing slots, etc, could allow another carrier to enter this market that might serve it equally well. From a national pride perspective, the question again becomes whether it is a local or foreign carrier. The final issue in the bankruptcy of an airline is whether the loss of that carrier reduces the supply of aircraft seats on certain markets, a result that tends to raise airfares. Again, this would happen if we assume that other carriers do not move into the market to supply this capacity.

CONCLUSION

Obviously, any argument to withdraw government support from one of these carriers should be based on a more extensive study than we have presented here. Our intent was to raise these issues for more careful consideration. Our study has been limited to publicly available sources of data on international airlines and airports. This data is voluntarily reported and does not include data that might be considered sensitive by these entities. Further, we have not attempted to estimate the distribution of employees or operations within countries, the specifics in each city of operation (size, demographics, industry, etc), possible losses to shareholders, etc. Future research would include attempts to address these limitations.

The fact remains that whether future studies of economic impact are conducted within Eastern Europe, governments will have to address these considerations because taxpayers demand it and the European Commission requires it. In early 2012, the European Commission ruled that Hungary's 66 year old national flag carrier should repay the government aid it had received between 2007 and 2010. As a result, Malev has ceased its operations and may be just one of many national airlines to follow suit in the upcoming future.

In an integrated European economy with a number of traditional and low cost carrier options, government efforts to support struggling national carriers do not seem to make economic sense. They certainly do not appear to have produced viable, competitive carriers capable of developing and retaining a sustainable market share. Sadly, there is no reason to assume that additional capital will produce different results. This money might be better spent encouraging other carriers to enter these markets.

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APPENDIX

Table 2: Airport Operations in select Eastern European countries, 2006-2010 (Domestic and Intl passengers in millions; Domestic and Intl cargo in thousand metric tons) *Source: Flightglobal, 2011*

	2010	2009	2008	2007	2006
1. Bulgaria					
Sofia Int'l					
Terminals	2				
Runways	1				
Airlines	40				
Domestic PAX	0.179	0.169	0.139	0.094	0.058
Int'l PAX	3.114	2.959	3.22	2.738	2.201
Domestic Cargo					
Int'l Cargo	13.5	13.3	16.6	15.7	13.6
Bourgas					
Terminals	1				
Runways	1				
Airlines	7				
Domestic PAX	0.015	0.014	0.016	0.012	0.002
Int'l PAX	1.86	1.676	1.91	1.929	1.801
Domestic Cargo					
Int'l Cargo	5.7	2.7	1.5	2.1	0.4
Varna Int'l					
Terminals	1				
Runways	1				
Airlines	5				
Domestic PAX	0.155	0.156	0.12	0.08	0.054
Int'l PAX	1.045	1.054	1.285	1.401	1.468
Domestic Cargo					
Int'l Cargo	0.1	0.1	0.1	0.1	0.3
2. Czech Republic					
Prague					
Terminals	6				
Runways	3				
Airlines	59				
Domestic PAX	0.109	0.002	0.031	0.127	0.123
Int'l PAX	11.413	11.606	12.565	12.269	11.431
Domestic Cargo	0.5		0.4	1.3	0.7
Int'l Cargo	52.1	36.6	41.4	47.5	48.3

	2010	2009	2008	2007	2006
Brno-Turany					
Terminals	1				
Runways	1				
Airlines	4				
Domestic PAX	0.032	.044	0.037	0.036	0.031
Int'l PAX	0.326	0.349	0.421	0.345	0.031
Domestic Cargo					
Int'l Cargo	5.3	9.7	6.2	3	3.1
Ostrava Mosnov					
Terminals	1				
Runways	1				
Airlines	5				
Domestic PAX	0.063	0.076	0.091	0.092	0.096
Int'l PAX	0.181	0.194	0.22	0.207	0.174
Domestic Cargo			0.1	0.1	0.1
Int'l Cargo	0.2	0.1		0.4	0.7
3. Hungary					
Budapest					
Terminals	4				
Runways	2				
Airlines	45				
Domestic PAX					
Int'l PAX	8.168	8.061	8.409	8.558	8.231
Domestic Cargo					
Int'l Cargo	60.2	49.8	58.8	64.3	61.2
4. Latvia					
Riga Int'l					
Terminals	3				
Runways	1				
Airlines	19				
Domestic PAX	0.001		0.031	0.015	0.002
Int'l PAX	4.649	4.055	3.646	3.131	2.479
Domestic Cargo					
Int'l Cargo	7.1	5.1	5	6	10.5

	2010	2009	2008	2007	2006
5. Poland					
Warsaw					
Terminals	3				
Runways	2				
Airlines	45				
Domestic PAX	0.919	0.827	0.934	1.047	0.917
Int'l PAX	7.77	7.473	8.515	8.222	7.184
Domestic Cargo	0.6	0.7	1	0.4	0.4
Int'l Cargo	40.3	32.6	36.7	37.7	36.4
John Paul II Int'l					
Terminals	2				
Runways	1				
Airlines	16				
Domestic PAX	0.195	0.185	0.187	0.203	0.194
Int'l PAX	2.639	2.48	2.722	2.844	2.16
Domestic Cargo					
Int'l Cargo	1.2	1	1.1	1.2	1.1
Katowice					
Terminals	1				
Runways	1				
Airlines	8				
Domestic PAX	0.024	0.268	0.027	0.057	0.048
Int'l PAX	2.357	2.076	20.81	1.915	1.391
Domestic Cargo	0.3	0.2	0.5	0.4	0.8
Int'l Cargo	10.2	6.5	12.5	7.8	6.1
Poznan					
Terminals	1				
Runways	1				
Airlines	8				
Domestic PAX	0.106	0.092	0.11	0.1	0.09
Int'l PAX	1.285	1.15	1.154	0.771	0.562
Domestic Cargo	0.1	0.1			
Int'l Cargo	0.1	0.1			

	2010	2009	2008	2007	2006
Wroclaw					
Terminals			1		
Runways			1		
Airlines			10		
Domestic PAX	2.11	0.2	0.2	0.222	0.192
Int'l PAX	1.388	1.124	1.279	1.049	0.667
Domestic Cargo	0.1	0.1	0.1	0.1	0.2
Int'l Cargo		0.1	0.1	0.4	0.8
6. Slovakia					
Bratislava					
Terminals			1		
Runways			2		
Airlines			9		
Domestic PAX	0.042	0.108	0.193	0.174	0.116
Int'l PAX	1.616	1.593	2.012	1.801	1.789
Domestic Cargo					
Int'l Cargo	17.7	11.9	6.9	1.9	5
7. Romania					
Arad Int'l					
Terminals			1		
Runways			1		
Airlines			1		
Domestic PAX	0.008	0.018	0.01	0.001	0.001
Int'l PAX	0.005	0.042	0.087	0.028	0.009
Domestic Cargo					
Int'l Cargo	0.8	0.7	0.5	0.8	0.4
Bacau					
Terminals			1		
Runways			1		
Airlines			2		
Domestic PAX	0.025	0.029	0.033	0.01	0.005
Int'l PAX	0.213	0.167	0.086	0.103	0.036
Domestic Cargo					
Int'l Cargo					
Bucharest Henri Conada Int'l					
Terminals			2		
Runways			1		
Airlines			37		
Domestic PAX	0.601	0.496	0.497	0.389	0.276
Int'l PAX	4.316	3.985	4.566	4.548	3.221
Domestic Cargo	0.1	0.1	0.2	0.2	0.1
Int'l Cargo	19.9	18.3	18.8	14.3	15.4

Table 3: Overview of National Flag Carriers

	Poland	Romania	Czech Republic	Hungary	Bulgaria	Slovakia	Latvia
Flag Carrier	LOT Polish Airlines	TAROM	CSA Czech Airlines	Malev	Bulgaria Air	Slovak Airlines	airBaltic
Operations	1929	1920	1923	1946-Feb 2012	2002*	1996-Jan 2007	1995
Parent Company	State Treasury of Poland	Romanian State (the Ministry of Transportation)	Ministry of Finance of Czech Republic	MNV	Balkan Aviation Group	Austrian Airlines	Government of Latvia
Government ownership	68.00%	97.00%	92.00%	95.00%	1.00%	n/a	99.80%
Employees	2,305	2,486	2,022	n/a	n/a	n/a	1,193
Passenger Revenue (million)	$841.32	$348.00	$793.55	n/a	n/a	n/a	$366.98
Cargo Revenue (million)	$37.35	$5.65	$16.63	n/a	n/a	n/a	$6.31
Non-stop Destinations	56	33	53	n/a	24	n/a	

Source: Flightglobal **Successor to Balkan Bulgarian Airlines*

Table 4: National Flag Carriers Operations, 2006-2010
(Passenger, cargo and total revenue in US$ millions)

	2010	2009	2008	2007	2006
CSA Czech Airlines					
Passenger Revenue	793.55	931.87	1171.02	1021.17	n/a
Cargo Revenue	16.63	16.44	43.8	42.92	n/a
Total Revenue	1000.41	1080.89	1326.93	1159.65	1043.84
Net Margin	-0.79%	27.98%	2.10%	0.88%	1.69%
Total Passengers (mil)	5.04	5.38	5.62	5.48	5.47
Passenger Load Factor	71%	68%	67%	68%	72%
Total Employees	2022	4642	4642	4777	5247
Malev Hungarian Airlines					
Passenger Revenue	n/a	n/a	n/a	596.08	495.79
Cargo Revenue	n/a	n/a	n/a	18.47	17.87
Total Revenue	500	472.2	708.31	683.19	581.12
Net Margin	n/a	-26.0%	-12.0%	-0.6%	-8.9%
Total Passengers (mil)	3.05	3.22	3.12	3.15	3.22
Passenger Load Factor	67.1%	68.8%	68.3%	68.7%	67.2%
Total Employees	n/a	n/a	n/a	3374	3814
	2010	**2009**	**2008**	**2007**	**2006**

airBaltic					
Passenger Revenue	n/a	366.98	378.44	265.65	186.88
Cargo Revenue	n/a	6.31	6.48	n/a	n/a
Total Revenue	505.62	428.91	421.65	311.74	211.57
Net Margin	n/a	4.9%	-13.8%	1.0%	3.2%
Total Passengers (mil)	3.15	2.76	2.59	2.01	1.43
Passenger Load Factor	67.8%	68.4%	61.9%	63.2%	60.4%
Total Employees	n/a	1193	1286	917	790
LOT Polish Airlines					
Passenger Revenue	841.32	735.02	975.34	n/a	734.29
Cargo Revenue	37.35	26.71	41.92	n/a	35.55
Total Revenue	978.39	871.53	1184.16	1085.71	894.31
Net Margin	-1.8%	-6.2%	-25.7%	5.4%	19.3%
Total Passengers (mil)	4.5	4.1	3.97	4.27	3.7
Passenger Load Factor	7.5%	73.4%	72.8%	75.7%	74.4%
Total Employees	2305	3470	3730	3500	3538
TAROM					
Passenger Revenue	n/a	n/a	348	344.28	273.12
Cargo Revenue	n/a	n/a	5.65	5.09	5.7
Total Revenue	405.28	369.92	552.12	369.87	303.24
Net Margin	-25.8%	-20.7%	5.1%	11.5%	5.1%
Total Passengers (mil)	1.96	1.77	1.98	1.69	1.35
Passenger Load Factor	60.9%	55.0%	64.9%	67.3%	62.8%
Total Employees	n/a	2486	2460	2339	2346
Bulgaria Air					
Passenger Revenue	n/a	n/a	n/a	n/a	n/a
Cargo Revenue	n/a	n/a	n/a	n/a	n/a
Total Revenue	n/a	n/a	n/a	n/a	n/a
Net Margin	n/a	n/a	n/a	n/a	n/a
Total Passengers (mil)	1.05	1.15	1.25	0.81	0.95
Passenger Load Factor	67.4%	65.7%	68.7%	64.3%	64.4%
Total Employees	n/a	n/a	n/a	n/a	n/a

Source: Flightglobal, 2011 (no data for Slovakian Airlines is available)