Early identification of pandemic risk and mitigating actions in the airline industry

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The COVID-19 crisis had an extreme and almost immediate effect on the airline industry, with countries across the globe shutting down borders and limiting domestic travel to control the spread of the virus. The airline industry, alongside the broader tourism industry, is one that faces the most severe long-term disruptions, not only due to country-specific restrictions, capacity limitations and high ongoing fixed operating expenses, but also due to lower demand from leisure and business travelers to fly in times when there is not yet a vaccine against the COVID-19 virus available. This will likely keep air travel below 2019 utilization levels through to 2023.¹

Against this background, this paper strives to establish whether, and to what extent, pandemic risk had been on airline companies’ radars before the COVID-19 outbreak and/or when the novel coronavirus first grounded the industry. For this purpose, this paper analyses companies’ responses to the SAM Corporate Sustainability Assessment (CSA) and their annual reports for the financial years 2018 and 2019, with the latter published largely at the onset of the pandemic². Essentially, the question this paper asks is: Could the airline industry have been better prepared to mitigate the impact of COVID-19?

² Most companies of the sample published their 2019 annual reports between January and May 2020. They were therefore able to consider the impact of the COVID-19 crisis in their 2019 annual reports.
Key Take-Aways

- 70% of the airlines covered in this paper were aware of the fact that a pandemic is a material risk to the company. However, these companies did not see this risk materializing as one of the key threats to their business.
- In their respective 2018 and 2019 financial year reports, only three and five companies, respectively, mentioned the eventuality of travel restrictions being imposed by authorities. None envisioned a complete ban on flying.
- A large majority of the airlines appear to lack a mitigation plan to respond to such a disruptive event. In 2018, before the outbreak of the COVID-19 crisis, only two companies that reported pandemics as a risk also reported on corresponding mitigating actions.
- 64% of the identified controversies related to the COVID-19 crisis on the RepRisk ESG Risk Platform\(^3\) concern issues related to the health and safety of employees – a surprising finding considering that occupational health and safety is a material issue for 80% of the companies surveyed.
- Investors increasingly expect companies to disclose their preparedness to such events in order to assess the agility and resilience of companies and eventually their ability to survive in the long-term. Based on this analysis, many companies in the airline industry still have a long way to go to meet those expectations.

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Research Methodology

This paper covers 33 airline companies, with the sample limited to companies that were part of the eligible universe of the 2019 Dow Jones Sustainability Index and constituents of the S&P Global LargeMidCap Indices. The analysis starts by determining which companies had identified the risk of a pandemic in their public reporting, followed by an assessment of whether companies that had identified this risk also reported mitigating actions, and whether such measures may have had an impact on their crisis management. To this end, it was examined whether these measures were limited to improving health and safety measures or reflected a more holistic approach to crisis preparedness and disruption. In addition, an analysis was conducted on the extent to which companies have been subject to negative press regarding their management of the COVID-19 crisis.

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\(^3\) [www.reprisk.com](http://www.reprisk.com)
Pandemic risks are insufficiently reported

Global decision-makers polled for the World Economic Forum’s Global Risks Report⁴ regularly ranked the risk of infectious diseases among the biggest global risks in terms of impact over recent years. Nevertheless, the perceived impact of this risk has been decreasing over the last five years; it ranked second in 2015, and ninth in 2018, 2019 and 2020.

Not surprisingly, the data provided by companies for the SAM Corporate Sustainability Assessment (CSA)⁵ question on emerging risks showed that in the 2019 CSA, none of the 33 companies had mentioned “pandemics” as an emerging risk. Indeed, the risk of a pandemic was not considered as an increasingly important risk.

Given the airline industry’s high sensitivity to external shocks, whether it be natural disasters or dramatic changes in fuel prices, it is surprising that only 33% and 45% of companies, in their respective 2018 and 2019 financial year reports, reported on pandemic as a specific risk before the crisis and at its onset. In fact, it turned out to be one of the industries hit hardest by the COVID-19 crisis.

In 2018 and 2019, only three and five companies, respectively, mentioned the eventuality of travel restrictions being imposed by authorities. None envisioned a complete ban on flying.

Companies that report on the risk of pandemics often refer to the negative impact on demand due to fear of contagion and/or potentially negative operational impacts due to employees or contractors falling ill or being quarantined.

Out of the 33 companies analyzed, nine, and respectively eight airline companies included pandemic risk in their 2018 and 2019 reports in a list of external risk factors that also included such risks as wars, terrorism or natural disasters. Typically, these companies report on this risk in the risk factor section of their overwhelmingly standardized 10-K reporting to the US Securities and Exchange Commission. Most often, references are limited to a statement saying that this risk factor could materially impact the company’s financial results, profitability or operations.

⁵ The question on emerging risks asks for two important long-term emerging risks that have the most significant impact on the business and industry in the future.
Mitigating actions related to pandemic risks are not comprehensive

70% of the airlines covered in this paper were aware of the fact that a pandemic would cause a risk to the company. However, they did not see this risk materializing as one of the key threats to their business. 26 out of 33 airline companies identified health and safety as one of their material issues, but no reference was made to the health and safety of passengers and employees with respect to on-board diseases, viruses, etc.

Indeed, in 2018, only two companies that reported pandemics as a risk also reported on corresponding mitigating actions. One of these companies, Deutsche Lufthansa AG stated that:

- it conducted permanent monitoring of information published by health authorities for early detection of potential pandemic
- it introduced occupational health and safety measures consisting of information, protective equipment and vaccination.

The other company, Japan Airlines Co Ltd\(^6\) reported measures related to its business continuity plan, including:

- necessary policies and procedures to ensure staff safety
- maintenance of air transport operations and other operational services
- coordination with relevant government bodies and
- systems, and policies for handling diseases.

While it is difficult to draw any conclusion at this point, and a combination of other factors are to be considered as well, these two companies experienced a smaller average share price drop than their peers over the last seven months\(^7\) (-28.84% and -29.80%, respectively, compared to -38.42% for an industry benchmark\(^8\)\(^9\)).

In their 2019 reports (published early 2020), six companies that reported on pandemic risk also reported related mitigation measures, including the two companies mentioned above. The four additional companies (Korean Air Lines Co., Ltd., China Southern Airlines Company Limited, Air France–KLM, China Eastern Airlines Co) reported on coordination and cooperation with authorities for early detection of pandemics and health and safety measures for passengers and employees. None of the other 27 companies reported such measures.

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\(^6\) Please refer to the case study for more insights.

\(^7\) From December 31, 2019 until July 31, 2020


\(^9\) Data and analytics provided by S&P Global Market Intelligence
There is now public consensus that the impact of a pandemic is a major threat, now and in the future, and that it will transform the entire industry. Nonetheless, a majority of the airlines covered in this paper appear to lack a comprehensive understanding of these risks and mitigation plans that would correspond to such risk levels.

There is unfortunately no single recommended solution to be prepared for such a crisis. However, a comprehensive plan including not only health and safety measures for employees and passengers, but also elements such as those listed below could help prepare for disruptive events:

- a detailed scenario analysis
- a set of measures to keep the trust of customers and to prepare for a recovery
- flexibility in the way to allocate human and operational resources to adapt to the constant evolution of the crisis
- frequent and transparent communication about the situation with internal and external stakeholders.

COVID-19 negative media coverage

64% of the identified controversies related to the COVID-19 crisis concern issues related to the health and safety of employees — a surprising finding considering that the analysis previously showed that occupational health and safety is a material issue for 80% of the companies surveyed, and for the few companies that had mitigating actions in place, those related to health and safety.

The negative press coverage on the 33 companies analyzed for this paper focuses on ESG topics rather than financial or operational news. More specifically, news stories from the media and stakeholder groups compiled by RepRisk, a leading business intelligence provider specializing in environmental, social and governance risks, were reviewed.¹⁰

In total, 22 news stories on ESG controversies related to COVID-19 were identified from January 1 to June 30, 2020.¹¹ These 22 stories relate to 11 companies, with two companies involved in four incidents each.

A break-down of the news stories in categories as identified by SAM, part of S&P Global, shows that in 14 out of the 22 news stories, the controversial issues related to the health and safety of employees, with eight out of these also including passenger safety. Specifically, the news reports referred to a lack of protection and safety measures offered to flight attendants and passengers.

Four of the controversies related to controversial labor practices, such as wage dumping or unfair dismissals. Two news pieces related to excessive executive compensation amid the COVID-19 crisis and two news stories related to discriminatory practices toward passengers.

![Figure 3: Media coverage on COVID-19 related ESG controversies](source: S&P Global, with data from RepRisk, as on June 30, 2020)

¹⁰www.reprisk.com

¹¹Reported on the RepRisk ESG Risk Platform as on June 30, 2020. The same news story reported in different media is counted as one.
The airline industry has also been subject to media coverage regarding government bailout of airlines companies and refund policies. While this type of news also affects the reputation of companies, this was not in the ESG scope of this review.

To gain a better understanding of the possible correlations between insufficient pandemic preparedness and related controversies, companies with COVID-19-related controversies were mapped against companies reporting pandemics and/or COVID-19 as a risk, and companies reporting relevant mitigating actions. This exercise shows that even if some of the companies with controversies related to COVID-19 had identified pandemics as a risk, none of the airlines had previously disclosed mitigating measures linked to the identified controversies.

**Figure 4: From disclosing risks and measures to COVID-19 related controversies**

11 companies with ESG controversies related to COVID-19

... of which six had disclosed pandemic as a risk

... of which three had reported mitigating measures related to pandemic...

... of which none had measures related to the topic of the controversy.

*Source: SAM, part of S&P Global, with data from RepRisk, as on June 30, 2020*

While it is difficult to draw conclusions from the above results, a comprehensive scenario analysis identifying potential crisis outcome and corresponding measures could be a first step in helping companies manage a crisis and avoid related public criticism.
Conclusion

Given its extreme vulnerability to pandemic risk, one would have expected the airline industry to have had pandemic preparedness, response and recovery plans in place – particularly as this is not the first time a pandemic has impacted the travel industry: SARS, MERS and Zika have all significantly hurt the industry over the past two decades.

The analyzed data shows a different picture. Companies find it difficult to first report on risks with a potentially high impact but a perceived low probability and struggle even more to publicly report on a comprehensive action plan to respond to the disruptive effect of such risks, should they materialize. As observed by colleague S&P Global Ratings in their analysis of how companies deal with disruption, the COVID-19 crisis “calls into question how companies prepare for black swan risks, which are harder to predict, measure, and prioritize”.

Furthermore, the insufficient crisis preparedness also materializes in the media criticism that airlines face related to their mismanagement of the COVID-19 crisis, related not only to the health and safety of passengers and the labor conditions of employees, but also to the reluctance of many airlines to provide refunds to passengers for cancelled flights while simultaneously receiving millions from governments in bailout funds.

Many experts agree that the frequency of such disruptive events – from climate change to natural disasters – will rise in the coming years. Investors will increasingly expect companies to disclose their preparedness to such events in order to assess the agility and resilience of companies and eventually their ability to survive in the long-term. Based on the analysis in this paper, many companies still have a long way to go to meet those expectations.

Learn more about the SAM Corporate Sustainability Assessment (CSA):
www.spglobal.com/sg/esg/csa/
Case study: Japan Airlines Co Ltd

This case study provides an example of an airline that had identified the risk of a pandemic and reported on related measures before the outbreak of the COVID-19 crisis. The case study highlights some key takeaways about the company’s measures and policies that have potentially led it to avoid public controversies and be better prepared for a disruptive event.

Japan Airlines Co Ltd (JAL), the second largest airline in Japan and the third largest in the DJSI Asia Pacific region, has been reporting in its integrated reports since 2015 about its Business Continuity Plan (BCP) related to the risk of a pandemic. Within its Risk Management section, the company reports on its BCP established to respond to specific risks that threaten its ability to fulfill its responsibilities as a public transportation operator, such as pandemic influenza, unidentified infectious diseases or earthquakes. The BCP covers basic matters such as policies and procedures necessary to ensure the safety of JAL Group staff and their families and maintain air transportation operations essential to the Group, including reservations, information provision, payments and settlements. During the 2014 outbreak of Ebola in West Africa, the company activated its BCP regarding responses to pandemic influenza or unidentified infectious diseases. It coordinated its actions with relevant government bodies, developed necessary systems and added the Policy for Handling the Ebola Virus Disease to their BCP.

JAL, as most airlines companies, has been severely affected by the COVID-19 outbreak. As of April 2020, the company had to cut approximately 95% of international capacity and experienced a 70% reduction in its domestic capacity, due to entry restrictions to many countries, rapid fall in demand or request by the Japanese Government to avoid travel upon the declaration of the state of the emergency. As of July 31, the company’s share price had lost 44.7% of its value compared to December 31, 2019 and, on June 19, the company announced its plan to raise as much as 500 billion yen (USD 4.7 billion) to bolster its finances amid a slump in air travel demand caused by the coronavirus outbreak.

The price loss experienced by JAL, however, is less significant than most other airlines (S&P 1200 Airlines lost 49.95% during that same period). Moreover, the company hasn’t been subject to negative press regarding its management of the COVID-19 crisis.

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14 Data and analytics provided by S&P Global Market Intelligence
16 From December 31, 2019 to July 31, 2020. Data and analytics provided by S&P Global Market Intelligence
17 According to news reported on the RepRisk ESG Risk Platform, as of June 30, 2020.
Some of the measures that the company has taken in direct reaction to the crisis consist of sustaining its route network, of introducing health and safety measures (sanitizing aircraft thoroughly and taking preventive measures steadily to avoid infection for passengers and employees), but also in flexibly adjusting flight number and routes to the decreasing demand to save costs. Furthermore, as the passenger and flight number decreases, the workload of employees decreases. JAL uses this occasion to review operation manuals and provide enhanced training to improve its ability for further growth after the coronavirus infection. So far, the company has not announced any layoffs. Furthermore, the company was proactive in changing its cancellation policy to introduce a cancellation waiver to refund clients.

It is too early to draw any conclusions about the effectiveness of these policies and measures, and the second wave of infections affecting Japan in July 2020 certainly reduced the hope for a fast recovery, however, the focus of passenger satisfaction is an additional element that potentially helped the company navigate through the crisis. A survey from JD Power shows that among carriers flying from North America to Asia, Japan Airlines ranks highest in passenger satisfaction, with the “primary drivers of airline selection” being past experience with the airline (40%); good customer service (36%); convenient scheduling (35%); reputation (33%); and lower ticket price (31%).

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18 The Japanese government declared a one-month state of emergency on April 7, which was extended until end of May, however, it has not asked airlines to reduce flights.
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