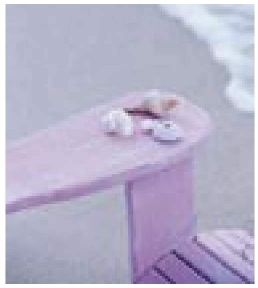

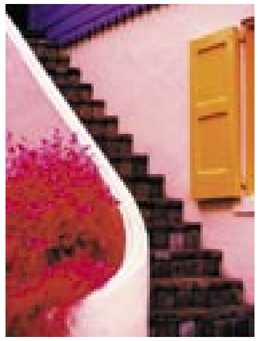

ST. THOMAS
ST. JOHN
ST. CROIX

# USVI

**AIR SERVICE MARKETING AND DEVELOPMENT**
UNITED STATES VIRGIN ISLANDS

## DRAFT
## EXECUTIVE SUMMARY

prepared for

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## Executive Summary

High quality and attractively priced air services are critical to the development of the Virgin Islands. They help the Islands to compete as a financial and manufacturing center, and are of particular importance in bringing high value tourists to the Virgin Islands. In 2001, the average cruise ship passenger spent only $269 per visit, while visitors arriving by air spent an average of $1,025 per visit.[1] Since the travel and tourism industry generates over 40% of the Virgin Islands' gross domestic product[2], successful strategies for increasing air arrivals will have a disproportionately large impact on the community's prosperity.

*Tourism and High Quality Air Access are Critical to the Prosperity of the Virgin Islands*

In February 2002, the University of the Virgin Islands, acting on behalf of the Legislature, commissioned the transportation consultant Edwards and Kelcey to develop a comprehensive strategy for increasing air arrivals. The strategy encompasses the key steps needed to expand the tourism industry and better position the USVI in other economic areas. It will improve the USVI's quality of life through integrating the population with the world economy. The strategy, however, reflects current realities: the dismal state of the airline industry, and a marked decline in air traffic worldwide. It includes both short and long-term objectives for increasing the number of air arrivals to both St. Thomas and St. Croix.

### Airline Industry: Global Trends and Significance to the USVI

The airlines will be the key agents for executing the strategy to increase air arrivals. However, the airline industry faces a crisis without precedent. It is currently operating at a loss, in 2002 losing over $1 million every hour. Exhibit 1 illustrates the current and historical operating losses of US air carriers. This makes expansion by airlines a very challenging prospect. Declining revenues and increasing price competition have placed airlines under intense pressure to cut costs. This pressure has filtered down to airports, which find themselves pressed by airlines to discount services and undermine their own financial prerogatives.

*The Airline Industry is in an Unprecedented Financial Crisis*

The current state of the industry has also strengthened the position of the low-fare carriers. The low-fare carriers have continued to growth, and now account for 20 percent of the market. They have achieved this through strict adherence to cost control measures. The cost of a low-fare carrier, unhindered by complex labor and

[1] Source: Caribbean Tourism Organization
[2] Source: The Virgin Islands, The Impact of Travel and Tourism on Jobs and the Economy, World Tourism and Travel Council

operational patterns, is typically much lower than that of a network carrier. The current market environment plays a critical role in the determination of effective air service strategies for St. Thomas and St. Croix.

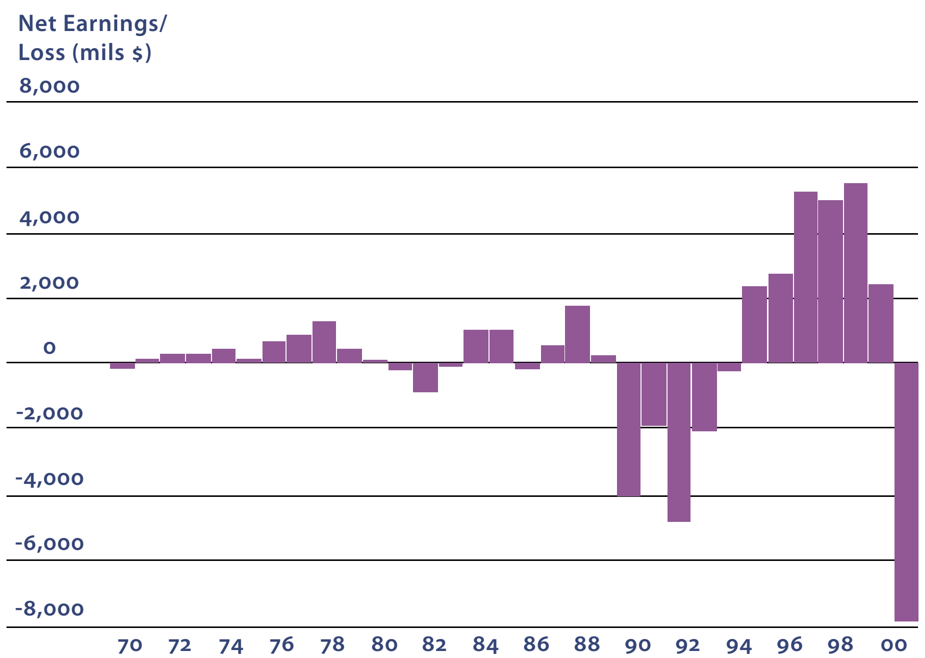


Exhibit I
Net Earnings/Loss of Domestic Air Carriers
Source: Air Transport Association

Analysis of the passenger data to and from the USVI was instrumental in the development of an appropriate air arrivals strategy. Passenger traffic at St. Croix has fallen steadily in the 1990s. As shown in Exhibit 2, current volumes are less than half those of the early 1980s. The decline since 1995 results primarily from reduced boardings by American Airlines, exacerbated by the cessation of Delta and Continental services. Air traffic declined in 1995 at St. Thomas due to Hurricane Marilyn. It has, however, rebounded through the late 1990s. Traffic by American Airlines has seen a modest increase, however most of the Airport's growth has resulted from enhanced services by US Airways and Continental Airlines.

The load factors (the percent of filled seats) on flights operated to and from the USVI are in the 65 – 70% range as shown in Exhibit 3. US Airways maintains the





highest load factors with 80% on the St. Croix – Philadelphia route. Most of this traffic boarded in St. Thomas. USVI load factors are low for a leisure destination, and are significantly below the break-even load factor for the airline industry as a whole. The USVI's mediocre load factors suggest that aggregate seat capacities are adequate and that there is no shortage of flights.

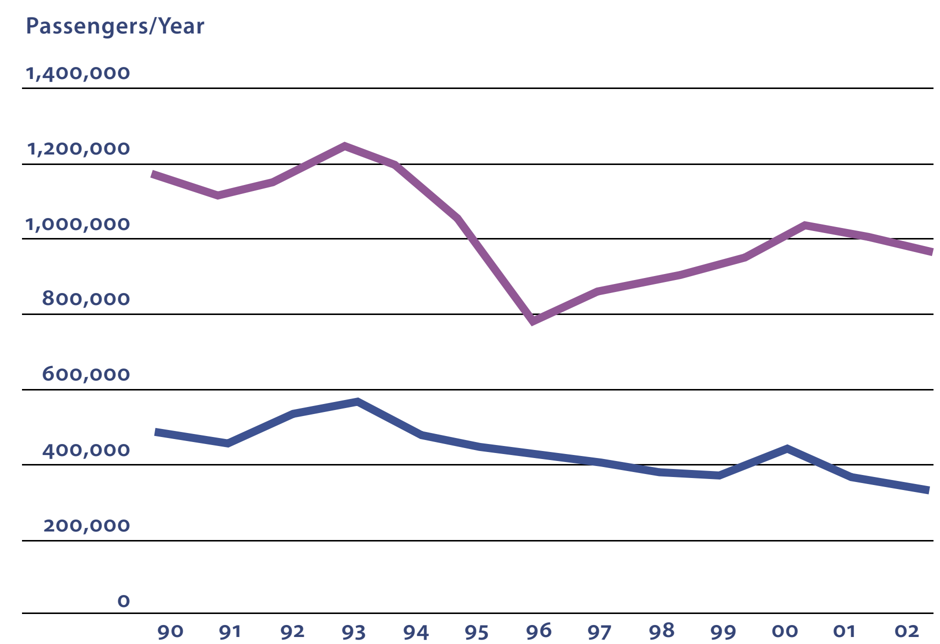


Exhibit 2
Traffic at the Henry E. Rohlsen Airport, St. Croix and Cyril E. King Airport, St. Thomas
Source: United States Department of Transportation Report 28DS and C298

Henry E. Rohlsen Airport
Cyril E. King Airport

The number of passengers traveling between the USVI and Puerto Rico has steadily declined since 1995, while long haul markets to the US mainland have experienced steady growth. The St. Thomas – Northeast US market has shown a particularly strong performance. Since the likely focus of any initiative to increase air arrivals must focus primarily on long haul services, these are very encouraging trends.

***Air Traffic to the Mainland has Grown Strongly at both Airports***

Direct international traffic to neighboring islands in the Caribbean is modest, however long haul international passengers traveling to and from the USVI account for 8.07% of the mainline traffic at St. Croix and 5.52% at St. Thomas. At both airports, this component has grown at twice the rate of domestic traffic. The growth in international markets has important implications to the air arrivals strategy for the USVI.

Although St. Thomas is the gateway to the USVI, the quantity of connection traffic is modest. Most passengers traveling onward from King Airport to the British Virgin Islands use ferries rather than scheduled aircraft. Statistics suggest that air-to-air connection traffic is very limited. This is a key factor in the recommendation not to pursue a hub strategy for the airports.

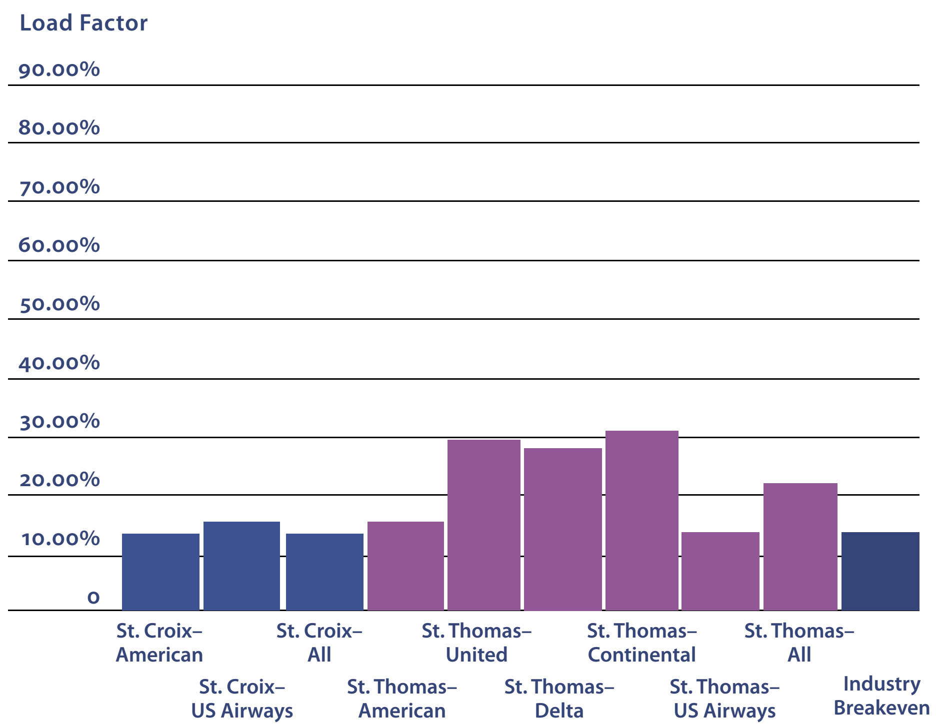


Exhibit 3
Load Factors by Airline at St. Croix and St. Thomas
Source: United States Department of Transportation Report 28DS Air Transport Association, "U.S. Airlines - The Road to Resuscitation," January 2003

Short notice fare levels to and from the USVI are commensurate with the average distance traveled. Average fares are somewhat higher than the norm, but the modest differences are not statistically significant. Fare differentials between the USVI and other Caribbean resorts neither provide any major advantage nor pose any disadvantage in attracting air arrivals to St. Thomas and St. Croix.

None of the trends suggest that the current industry environment makes marketing efforts futile, nor do they imply that the islands are likely to obtain a large capacity increase in the immediate or distant future. Efforts to market the Islands directly to prospective carriers, with sophisticated presentations and route evaluations, while important, are only a supplementary part of the process of





increasing air arrivals. Rather, EK analysis uniformly indicates that an effective strategy should be locally based, and should address two core elements:

1. The manner in which the USVI are promoted to prospective visitors; and

2. The airline economics of serving the Islands, specifically user charges at the Cyril E. King and Henry E. Rohlsen Airports.

## Perspectives on USVI – The Community and Airlines

*No Organization or Person has a Clear Mandate to Lead the VI's Air Service Development Efforts.*

The strategy to increase air arrivals took into account the viewpoints expressed by government, community, and business leaders. Several conclusions were borne out of the discussions with the USVI community.

First, the economic importance of quality air services to the USVI economy is not widely understood in the community. Second, a comprehensive air service marketing strategy, a foundation to increasing air arrivals to the USVI, has not been developed. Third, there is no clear mandate by any island organization for the development and management of an ongoing air service development and marketing program. There are clear dangers that this effort could be fragmented among different organizations and persons, with little resultant leadership or focus. These community perspectives were an important contribution to the air arrivals strategy outlined later in this summary.

*Airlines Support Marketing Each of the Islands as a Distinct and Unique Destination, Appealing to a Particular Type of Visitor*

The airlines offered an outside perspective on the USVI. Many carriers believe that the USVI tourism promotion efforts should emphasize the diversity of the USVI. Each island would serve a different and distinct market niche, and appeal to visitors with different interests and needs. This contrasts with conveying a single and more homogeneous approach in which all islands are treated as one destination. Most airlines expressed concern that St. Croix could not be marketed to its fullest potential without first dispelling the perception of crime on the island. Airlines also felt efforts could be made to enhance the brief visits by cruise passengers and in turn make them repeat visitors. Additionally, air carriers felt that the airport should seize the leadership for resolving passenger departure bottlenecks by coordinating the efforts of airlines and federal inspections agencies. Several airlines felt incentives such as revenue guarantees might also be needed to stimulate air arrivals on St. Croix. They would be less effective on St. Thomas, where several carriers are already well established.

*The Recent Increase in Landing Fees Could Prompt Airlines to Cut Services*

The airlines are confused, disappointed and angry about recent increases in landing fees. They complained about the magnitude of the increase, its timing (after they had already designed and committed to their schedules), their economic circumstances, and what they viewed was a rather peremptory manner of announcing the increases. Airlines design their winter schedules for the VI during the spring and summer, and would respond with capacity cuts if the increases were not rescinded.

## Strategies for the USVI

The analysis of the industry, fare/passenger levels combined with the input from the USVI community and air service providers, yielded different pictures of each airport. Each airport, and the market it serves, exhibit different characteristics:

*St. Croix and St. Thomas are Different Markets with Different Needs*

The Cyril E. King Airport at St. Thomas is a well established destination.

- It is a gateway to the most populous, and most economically active parts of the Virgin Islands;
- It is the primary gateway to the renowned tourist resorts and the national park on St. John;
- Its catchment area boasts many excellent hotels and upscale resorts;
- Many prospective visitors are already familiar with St. Thomas through its prominent role as a cruise ship port;
- It is served by five network airlines nonstop to Puerto Rico and the U.S. mainland;
- It has high volume origin-destination markets to New York and Miami;
- It obtains charter and seasonal services; and
- Its traffic has grown in the recent past; even its post-2000 contraction was milder than those of most airports.

In contrast, the Henry E. Rohlen Airport on St. Croix faces different challenges:

- The economy on St. Croix, while boasting a strong industrial base, lacks the strength, vitality and diversification of other Islands;
- Air traffic at St. Croix is only 36.78% of that at St. Thomas;
- The St. Croix Airport is served by only two large carriers, American and US Airways;
- As a result of schedule reductions, American recently reduced staff at the airport and now uses American Eagle employees to handle both commuter and mainline services;



- The US Airways service originates in St. Thomas and boards only a small share of its traffic in St. Croix. The short St. Thomas-St. Croix leg involves very high operating costs. This service should be considered at risk;
- The hotel infrastructure on St. Croix tends to be smaller and less developed than elsewhere in the Caribbean;
- The attractions of St. Croix; historical areas, climatic diversity, and opportunities for eco-tourism, are different from what most people associate with the Virgin Islands. Those who visit the Islands are therefore somewhat unlikely to visit St. Croix; those who would most enjoy St. Croix may not be aware of its assets and are likely to go elsewhere in the Caribbean;
- Total air traffic at St. Croix has followed a lengthy period of decline. This resulted from decreased traffic to Puerto Rico. The post-2000 contraction of traffic was relatively severe.

The airports are very much a contrast in levels of service; therefore the air arrivals strategy outlines steps for St. Thomas, St. Croix, as well as the airports together, to account for their unique characteristics. Strategies are grouped according to sense of urgency and are outlined below. In depth information concerning each strategy can be found in the Technical Report.

## Strategies for Immediate Implementation (1 Month)

*The Small Community Air Service Development Program Offers an Immediate Opportunity for Funding*

The following strategies, schematically depicted in Exhibit 4, should be pursued with urgency. For greater detail please refer to Section VIII in the Technical Report.

1. **Apply for Federal Assistance Under the Small Community Air Service Development Pilot Program.**
   This program provides federal funds for the enhancement of air service to underserved markets. Applications are due June 30, 2003. Supporting analysis for the application should build upon the findings of the overall strategy/plan once endorsed by the Committee. Applications are due June 30, 2003.

2. **Develop Fees/Charges Incentives for Airlines now Serving the Islands.**
   Airlines have been given harmful signals in recent months, signals that will likely result in service reductions. Recognizing the limited room for action, any incentive may pre-empt potential winter service reductions.

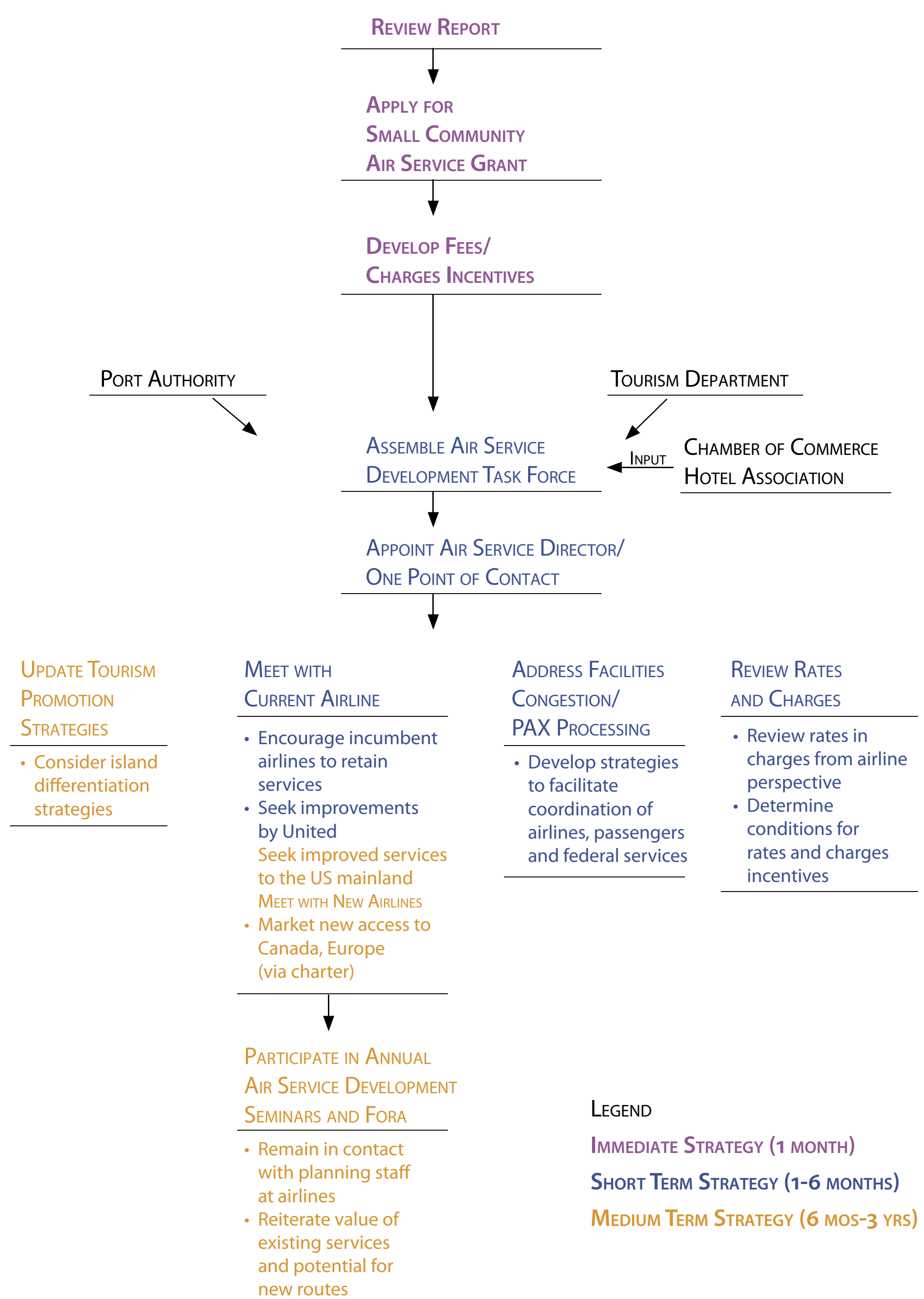


Exhibit 4
Recommended Air Service Development Strategies and Implementation Program





## Strategies for Short-Term Implementation (1-6 Months)

3. **Assemble an Air Service Development Task Force.**
   Air service marketing efforts for the USVI need too be professional, centrally coordinated, well-structured, and creative. An air service task force should be assembled from representatives of the Port Authority, the Department of Tourism and each island. This task force would consult with key stakeholders and set the air service development priorities for the USVI.

4. **Meet with Incumbent Airlines for Air Service Retention.**
   The air service task force should meet with airlines serving the USVI to encourage them to maintain current services.

5. **Review Port Authority Costs, Rates and Charges.**
   The Port Authority should review all aspects of its operations from the ground up with the goal of reducing costs. It should continue to manage the tightest cost control possible, given current airline sensitivity.

6. **Address Facilities Congestion at King Airport, St. Thomas,**
   The Port Authority should work with the airlines and federal inspection services to facilitate the smooth processing of inbound and outbound travelers.

7. **Seek Improvements in Service by United Airlines.**
   A short term goal of the Task Force should target the upgrade of United Airlines weekend-only services to a daily operation.

## Strategies for the Medium-Term (6 months – 3 Years)

8. **Upgrade Tourism Promotion Strategies.**
   Greater interest should be stimulated in visiting the USVI by capitalizing on each island's unique affinity to specific repeat-traveler groups.

9. **Participate in Air Service Development Seminars and Fora.**
   The Task Force should invest in Air Service development expertise to learn new techniques and develop industry contacts.

10. **Seek Improved Service to the U.S. Mainland.**
    The Task Force should meet with incumbent and prospective airlines to seek new capacity, particularly new routes to the mainland including:

*An Air Service Development Initiative Needs Effective Leadership and the Support of All Stakeholders*

*Low Airport Fees are Key to Attract and Retain Airlines*

*Promotion of the Virgin Islands as a Destination is the Key to Increasing Air Arrivals*

*Efforts to Attract More Carriers should be Coupled with Efforts to Promote the Virgin Islands as a Destination*

*New Services Should be Pursued Selectively*

- Northwest: STT to Memphis or Detroit
- JetBlue: STT to New York
- Spirit Airlines: STT to Orlando
- USAirways: STT to Pittsburgh
- Delta Air Lines: STT to Cincinnati
- American TransAir: STT to Chicago-Midway
- Continental Airlines: STT to Houston
- American: STX to New York and additional flight to Miami
- Delta: STX to Atlanta
- Continental: STX to Newark
- US Airways: Higher frequencies, STX to Charlotte

These recommendations should be qualified as follows:
- They should be pursued selectively. The financial health of each carrier, and of all carriers serving the Virgin Islands, must be important factors in determining which carriers to pursue for new routes;
- Runway restrictions at St. Thomas may limit the viability of certain nonstop routes, forcing intermediate stops at either San Juan or St. Croix; and
- Most importantly, such efforts to expand capacity should only be undertaken as part of an effort to stimulate demand through promoting the Virgin Islands as a destination.

*Revenue Guarantees May Help Encourage New Services at St. Croix.*

11. **Evaluate Revenue Guarantees for Services to St. Croix.**
    Resorts use revenue guarantees to encourage new services, resorts on St. Croix could offer guarantees as an effective means to attract improved services.

12. **Pursue Charter Services to the United Kingdom or Europe.**
    The Air Service Task Forces should seek a low frequency charter service as a precursor to a scheduled flight to Europe.

13. **Pursue Scheduled or Charter Services to Canada.**
    Discussions with Air Canada, Air Transat and Caribbean tour wholesalers should target a link to Toronto.

14. **Develop an International Transit Product for St. Croix's Henry E. Rohlsen Airport.**
    The Rohlsen Airport has potential to serve as a technical stop for trans-oceanic services. The airport could be marketed with incentive landing fees and if possible discount fuel prices.

# USVI

**AIR SERVICE MARKETING AND DEVELOPMENT STRATEGY**
UNITED STATES VIRGIN ISLANDS

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