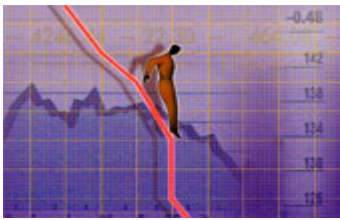


The "R" Word. Did you say Recession?

April 7, 2008

During my college years, economics was my chosen field of study. You may have heard economics being referred to as the *dismal science*. This isn't a very attractive description but if you continue reading, you may agree that it's an appropriate label.

In the classroom, I studied the ups and downs of business cycles in text books. I learned the economic principles well from these books and from my professors' lectures. Macro economics held that the nation was in a recession when the gross national product contracted for two successive quarters. Micro economics held that during a recession, an individual company struggled to sell enough products or services to stay profitable and those that weren't able to weather the difficult business environment would fall by the wayside.



Thus as a young student, I was fully able to recite the characteristics of a recession. However, my youth and inexperience prevented me from understanding the affect that a recession has on the nation's people. So, some 40 years later, along with age comes *maturity* (please allow me use that word) and perhaps a little *clarity* (maybe this is just wishful thinking on my part).

It's not what the Government says, it's about how the Consumer Feels

As of last week, no one in our Federal Government has gone on record as saying that the US in the midst of a recession. Yet last week's report of significantly higher unemployment, reports of huge declines of sales of automobiles, unimpressive reports of retail sales, skyrocketing price of gasoline and diesel fuel and record home foreclosure filings all point to a difficult time for many in our population. Whether these difficult economic conditions "qualify" as a recession, the fact remains that times are tough for many companies, individual and families.

I live in Michigan, a state that is highly dependent on the automobile industry. As sales of automobiles tumbled, the people of Michigan have experienced difficult times. The major automobile manufacturers have reduced both production and the number of employees. In turn, suppliers to the automobile industry and their employees have suffered. Additionally, the housing crisis has forced thousands to lose their homes. This paints a bleak picture for the state of Michigan.

I'm a creature of habit. For the last 15 years or so, I've stopped at the Dunkin' Donuts shop each morning on my way to the office. There, I pick up a cup of coffee and a donut that serves as my breakfast. When the shopkeeper recognizes me at the entrance door she readies a large coffee with cream and then asks what kind of donut that I'd like. Today, I need some sugar in my system so I tell her "*Bavarian cream, please*". I usually have the correct change for payment, exactly two dollars and sixty-nine cents. But today she tells me that my total is only \$1.90 because the donut is free with the purchase of a large container of coffee. In fact, she tells me that this special promotion lasts until the end of April. Next she grabs a small pre-printed card from beneath the counter, punches a hole through the card and hands it to me. "*When the card has seven punches, you'll get a free cup of coffee*" she tells me. This early morning encounter is another

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sign of a looming recession and my local Dunkin' Donuts franchise is responding by being very proactive, offering me a free donut - equivalent to a discount of 79 cents and encouraging me to return often. I proudly walk away from this donut chain having learned a **recession lesson**.

So how does all of this relate to aviation and flight simulation? Let's see.

Tales from the Airline Industry

Earlier in April, two airlines went out of business. First, **Aloha Airlines**, having served the Hawaiian Islands for sixty years, abruptly cancelled all of its passenger flights. So sudden was its shutdown that the Hawaiian Tourist Board stepped in to charter additional flights from other airlines to help stranded tourists with return flights to the mainland. Aloha claimed that intense competition from go! Airlines forced the company to drop its ticket prices. Along with lower revenues, the company's annual costs soared by some \$500,000 for each one-cent increase in the price of fuel. Keep in mind that the price of jet fuel has increased by some 40 cents since early January 2008. Ouch! Consequently, some 1,500 employees are said to be without jobs while Aloha's cargo division continues to operate under Chapter 11 bankruptcy protection.

A few days later, **ATA Airlines** with headquarters in Indianapolis, IN halted all of its flights. Normally it flies 20 aircraft on some 50 daily flights that carry 10,000 passengers. Its surprise filing for bankruptcy disrupts the travel plans of thousands and leaves more than 2,200 employees without jobs. In addition to losing a large military charter contract, the significant increase in the price of jet fuel is a major factor in its decision to cease operations.

Next, Columbus, OH based **Skybus Airlines** also filed for bankruptcy. More than 350 employees were affected by the closing. Skybus, which flies a fleet of 6000-gallon capacity A-319's also cited the cost of jet fuel as one of the prime reasons for its demise. With thirsty aircraft, it's expensive to fill 'her up. It looks like Skybus won't need the 65 Airbus A319s that it has on order with maker Airbus.



Yesterday (April 11), **Frontier Airlines** filed for bankruptcy protection after its credit card processor announced that it was planning to withhold portions of the proceeds from airline ticket sales. Frontier officials have gone on record saying that the company continues to experience strong demand and will continue to fly. In the mean time, it will use the legal protection to line up additional financing for operations. Based in Denver, CO, Frontier flies some 75 aircraft and has 6,000 employees.

To further drive home the difficulty in the airline industry, I refer to **Champion Air**, based in the Minneapolis, MN suburb of Bloomington. Champion has already announced plans to shut down its operations by the end of May. On the Champion website you'll read: *"...our business model is no longer viable in a world of \$110 oil, a struggling economy and rapidly changing demand for our services"*. When it ground its fleet of fuel-guzzling 727's on May 31st, Champion Air will furlow another 550 employees.

If we go back to early March, we learn that **Southwest Airlines** was fined more than \$10 million by the Federal Aviation Administration for allowing more than 30 737s to fly without inspections for structural damage during 2007. In response to the FAA action, other airlines have been reviewing their maintenance records. Earlier this month, **United Airlines** voluntarily cancelled about half of its 777 flights while it inspected the fire suppression systems in the plane's forward cargo hold. And just this week, **American Airlines** has cancelled some 3,000 flights using MD-80 aircraft to re-inspect the electrical wiring in the wheel wells. Can you imagine the ire of the passengers who were left at the gate?

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Maybe you're heard the recent rumblings coming from **Heathrow Airport** which serves the greater London area. Earlier this month **British Airways** was forced to cancel more than 250 flights from its brand new Terminal 5 due to problems with its baggage handling system. These severe shortcomings led to a backlog in forwarding 15,000 pieces of luggage. Passengers reported flights leaving Heathrow without any luggage onboard. Oops.

As airlines work their way through an uncomfortable series of flight disruptions and travel discomforts, they are also dealing with dramatically increasing costs, intense competition, slacking demand and banking woes. And still many continue to whisper the "R" word. But as higher ticket prices drive travelers away from the boarding gates, the airlines continue to suffer enormously. Most likely, most in the industry already understand the R-word very well. Among the unfortunate consequences of these deteriorating conditions is the loss of jobs to these employees and the disruption to their families.

Tales from the Flight Simulation Add-on Industry

Over the past six months, I've had conversations and communications with quite a few makers of flight simulator add-ons. While it would be inappropriate for me to divulge any confidential information, most have told me that it will be very "challenging" to remain profitable during the year. After mulling over these conversations for some time now, I've come up with the following observations.

The introduction of FSX fragmented the market. FSX demands more computing power. Many users find that the cost to acquire new hardware to handle FSX performance requirements is too expensive for them at this time. Further complicating the purchase of new hardware for FSX is the learning curve that a user experiences with Windows Vista. The result is the de-facto existence of two major user bases - the FSX users and the FS2004 users.



In general, add-on makers have a choice. They can produce a title that targets FSX users; they can produce a title that targets FS2004 users; or they can produce a title that targets both FSX and FS2004 users. An add-on maker that lacks the resources to target both FSX and FS2004 user is left to make the painful choice to target only one group. This is a common problem in economics – how to allocate your scarce resources – money, people, knowledge.

Of course, we all know that not all FSX users are the same. And likewise, we are aware that not all FS2004 users are the same. I don't believe that there is a *typical flight simmer* and I'll argue that point below as I try to dissect this market.

Take the hobbyists that obsess about aircraft add-ons. One simmer may prefer to fly the heavy metal airliners, while a second likes to fly small, general aviation planes and a third enjoys the speed, thrill and agility of flying military aircraft.

Now among those simmers that gravitate towards airliners, one individual may choose an add-on that duplicates each and every switch, annunciator and gauge in the real aircraft, along with a correspondingly long and structured checklist for each flight operation. It takes considerable concentration to get such a complex aircraft off of the ground in Flight Simulator. On the other hand, a second simmer may prefer to just jump into the left-hand seat, shove the throttle forward, takeoff and fly. So here are two simmers at different ends of the aircraft realism spectrum. Their wants, needs and expectations vary widely so the same add-on aircraft is not likely to satisfy both

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types of simmers.

A different hobbyist may take an intense interest in the visual surroundings. As such, he or she may prefer add-ons that are oriented towards realistic terrain, airport enhancements, new scenery and varying environments. Still another may take pleasure in being part of a virtual airline where he or she contributes to the operation of an imaginary company. Then there are those who want to create their own flight simulator worlds - whether it be creating their own aircraft or reproducing their favorite airport.

Continuing like this, we see that the typical flight simmer is not an individual, but a matrix of buyer preferences. Add-on makers study these preferences closely and mold their offerings to satisfy the requirements of buyers that compose one or more cells of the matrix.

Add-on makers that sell in the retail store environment find the **distribution channel** receptive to titles that appeal to users who fall into the cells with the largest number of potential buyers. One of the easiest ways to reach a wide audience is to include both FSX and FS2004 users. The distribution channel is less interested in a title that excludes one of these groups.

While the channel is huge, the retail chains have divergent attitudes towards flight simulator add-ons. Some chains are dropping flight simulator titles altogether in favor of the more popular console game titles. Other chains are proceeding cautiously and stock only a limited number of add-on titles in these "fragile economic times." Still others are quite aggressive and have increased their selection of flight simulator add-ons. In today's **soft** economy, it will be a challenge for any add-on to maintain enough shelf power so that the retailer continues to stock it.

Add-on makers that sell though the Internet are finding it increasingly difficult to attract web traffic. We've seen several creative and innovative add-on makers pop up on the Internet recently. With an online only business model, their success depends on their ability to identify and reach their specific audience. Other things being equal, a product that targets a sparse matrix cell (read: fewer potential buyers) requires more marketing to maintain a profitable level of sales compared to a product that targets a dense matrix cell. Still, lower discretionary income and fears of a recession are affecting buyer spending habits at least according to makers with whom we've talked.

Combating the "R" Word

As a cautious consumer, I have a few suggestions for you to maximize your flight simulator enjoyment without breaking the bank.

There has never been a time when you can find as many **freeware** add-ons as now. You can find original and modified aircraft of all categories - airliners, military, rotorcraft, general aviation, experimental, concept, and more. Aircraft repaints in popular liveries are among the most frequent new additions appearing daily. You'll find these free add-ons at the download libraries of the major flight simulator websites. Both Google and Yahoo are good places to start your search. There are literally thousands of freeware add-ons available and they vary widely in quality and usefulness. You may have to try several before you find one that meets your needs or likes, but heck they're free.

Many retailers are already offering products at **sale prices**. In a slowing retail environment, discounted or sale priced items are a common way to attract customer traffic. We've seen significant price reductions in stores making popular add-ons less expensive for the economically anxious customer.

Recently, we've seen several add-on makers announcing **discounts for online purchases**. Scour the Internet and you'll find discounted prices for many download add-ons. By eliminating the DVD or CD-ROM, an instruction manual, the packaging and shipping costs, add-on makers

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can deliver downloads at a discount and remain profitable. Expect to see more of these discounts. If you're an FS2004 user and have hopes of soon moving to FSX, search for add-ons that offer you an upgrade path. A package for FS2004-only may be less appealing to you if you are planning to acquire FSX shortly. Luckily, many makers offer the same package for both FS2004 and FSX, enabling you to stretch out the life of that add-on.

As consumers continue to feel the pinch of jumping gasoline prices, rising food costs and job concerns, they'll be an inclination to keep a tight grip on the wallet. This may lead to a **drop in retail prices** as add-on makers compete for a waning share of an individual's discretionary income. Look for lower-priced add-ons in the near future as add-on makers try to keep their goods affordable.

Conclusion

As a global maker of add-ons, we are entrenched in the world of flight simulator. Like others, we depend on a strong consumer demand for our products to remain viable. Although we believe that we've selected the correct cells of the customer preference matrix, we can never be sure. But knock on wood; thus far in 2008 we are fortunate to have had excellent sales. Our offices are in Michigan and this makes our successful performance completely at odds with what is happening around us. We just hope that the recession monster isn't waiting in the wings to attack us in coming months.

I started out by referring to the study of economics as the dismal science. The word dismal may not apply to the masses, but to someone who has lost a job it may be an apt description. Geographically speaking, the downturn in the economy is uneven. Some parts of the country are prospering while others are as dismal as Michigan's economy. We hope for new jobs for unemployed workers and a speedy recovery for many of the businesses in our community.

As a smart consumer, we trust that you'll spend frugally and spend wisely. But we certainly hope that you'll continue to spend....

Editorial written by [Arnie Lee](#)

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