

**Session 1b**

**INTERNATIONAL INITIATIVES**

**WEDNESDAY 28 AUGUST 11.00 - 12.30PM**

**THE FUTURE OF AVIATION IN THE PACIFIC RIM**  
**Peter Harbison**

**TRANSPORT INFRASTRUCTURE AND AID  
EFFECTIVENESS. AN ANALYSIS OF THE PACIFIC  
ISLAND REGION**  
**Colin Gannon, David Bray & Ian Gordan**

**APEC: ADVANCING TRANSPORT LIBERALISATION**  
**Nigel Mouat**

**Session Chair: Kevin Ward**

**ATRF 96**

The logo for ATRF 96 features a stylized map of Australia, composed of several overlapping, semi-transparent shapes that form the outline of the continent. The text "ATRF 96" is printed in a bold, sans-serif font across the middle of the map.

***"Future Aviation in the Pacific Rim:  
Dreams and Nightmares"***

**Australasian Transport Research Forum Conference  
28 - 30 August 1996 Auckland NZ**

**Peter Harbison**

**Managing Director**

**Centre for Asia Pacific Aviation**

Last month a friend of mine went to check in for a flight from Sydney to Los Angeles. When he arrived at the desk the check-in staff said to him "you're in luck". Now if that were me I would think, "good, it's full in economy and they've had to upgrade me." In his case, as he was travelling first class, the only place further forward he could move was to the flight deck. He couldn't imagine in his wildest dreams that he would ever earn as much as a captain would, so that wasn't an option.

In fact, the check-in lady said "you're going to be sitting next to Claudia Schiffer for the next 15 hours".

Now that struck a particular chord with me, as I'm sure it would with a number of you. If you travel reasonably often by air, you would know what I mean. For most of us, travelling first class is only a dream, but the prospect of sleeping beside Claudia Schiffer for 15 hours transcends even that.

The reality in fact is, as you well know, that you invariably end up sitting in economy class surrounded by screaming kids or drunks or both. If you are lucky enough to make it into business class, then the highest probability is that you'll sit next to somebody who won't stop talking and, when he does, it's only to close his eyes and snore loudly for the rest of the way.

In a nutshell, that is what the aviation industry is about. The dream is far from the reality. Every year people rush to start up new airlines when there are other perfectly good ways of losing lots of money. Those already in the airline industry forecast optimistically. Even more paradoxically, they talk about such things as divestiture of core activities - meaning that they sell off all the profit making parts of their business and stick to losing money with the airline.

Obviously some of the above is a little tongue in cheek. You have an airline in this country which has been singularly successful in making profits. There might even be more than one airline in future. But the constant factor is the gap between expectations and realities: "dreams and nightmares."

Today I want to share with you some of the results of a survey which we conduct annually of airlines and airports in the Asia Pacific region. I think you will find it points up a number of interesting current issues and also indicates some trends in thinking. Some of them are in the same vein.

There are certain regulatory and other external environmental causes which drive airlines into impossible positions. Likewise airports, with massive fixed investment and needs for long term planning, are entirely at the mercy of discretionary travel habits and airline operations.

There are two particular features of the regulatory environment which go to making airline planning (and therefore, indirectly, airport planning), difficult. Firstly, increasing deregulation of the international market place. This does not happen evenly across each of the international or domestic markets in which the particular airline operates. It is unpredictable in its spread, yet it can have a dramatic impact on short and medium term planning.

The second feature, which largely distinguishes the aviation industry from other international operations, is the constraint on foreign ownership of international airlines. That is to say, cross-border ownership and cross-border mergers are either prohibited outright or extremely complex to develop and administer.

The reason I link these two features together is that while one of them - deregulation - is driving high levels of competition, the other prevents them from combining resources to create a greater capacity to survive in the market place. It is for this reason that we are now beginning to see a proliferation of airline alliances, bringing with them another whole range of complexities for the airlines to manage.

One of the other ongoing studies which we conduct at the Centre is a quarterly review of airline fleets and aircraft orders in this region. I shall also refer to that during the course of this presentation, but there is one feature I would like to mention at this stage.

Airlines in this region currently have on order for delivery by the end of this decade somewhere between US\$100 - \$150 billion worth of aircraft orders. Let me just emphasise that it is not worldwide, that is just in this region, including Asian and Australasian airlines. Another similar amount - around US\$100 billion - will be spent on new airport developments and associated infrastructure projects over this period.

Now that is a lot of money by anybody's standards. Importantly, much of the airlines' investment will come from private funding, as airlines are becoming private sector operations.

An increasing part of airport investment will also have to be privately funded. Such bodies as the World Bank do not consider airport infrastructure investment to be a primary need of developing countries. It is therefore unwilling to lend governments the money to expand airports when other projects such as water, sewerage and surface transport infrastructure have much higher priorities. Moreover, even where the current funding is provided by government, the debt will eventually be financed by airlines. This is firstly because aeronautical charges reflect the cost of the loans and secondly because airports are set to move significantly into the private sector within a shorter time than most of us imagine.

I should say that all of this proposed investment is predicated on rapidly increasing tourism growth and business development to, from and within the Asian region. Therefore of course it is we, the business and tourism travellers, who will be paying for this infrastructure. The problem with us is that we are increasingly unpredictable and, as much of the money we are spending on these activities is discretionary, accurate predictions beyond the end of the next quarter can be a considerable challenge - let alone beyond the next twelve months.

#### **SLIDE 1 - Aircraft in service**

This slide shows movements in aircraft numbers among Asian carriers over the past two years. As you can see, there is a fairly wide spread of aircraft sizes with the smaller aircraft - under 120 seats - growing to 600 in service and the next largest category being those with over 350 seats, now approaching 500 in service.

## SLIDE 2 - Aircraft orders

The picture changes dramatically when we look at the number of aircraft currently on order as of June 1996. There is a continuing predominance of orders in the more than 350 seat category. There are in fact some 410 wide bodied long range aircraft currently on order among the 40 -odd carriers in this region. Most of these are for delivery within the next 5 years, with the bulk of them coming on line by the turn of the century. I should note of course these will not necessarily merely be added to the existing 500, as there is a process of replacement as well as expansion.

But this slide is interesting in that it suggests several structural things about the market. First of all, the predominance of orders for these large aircraft shows the dominance of long range intra-regional operation and the expected growth of intercontinental long haul services.

The second point is that the relatively low number of aircraft in the under 350 seat categories suggests that it will be some time before frequent services emerge between smaller gateway pairs within the region. This may be the result of more aggressive selling of the high prestige wide bodied aircraft with the higher seat cost efficiencies. The other side of this coin is that there will necessarily be a continued pressure towards hub gateways with air services operating either (1) between hub city pairs, or (2) between a hub gateway and a smaller gateway. Examples of these major hubs, which are likely to continue in importance are Singapore, Bangkok, Kuala Lumpur, Taipei, Tokyo, Seoul. The number is growing.

It is hard for smaller destinations to generate or attract significant long haul wide bodied operations. This has implications for the types of aircraft which some of these smaller airports can hope to see frequenting them over coming years and of the likely place of those airports in the competitive market for airport and airline services.

Thirdly, as part of this latter point, the predominance of wide bodied long range aircraft at these hub gateways means that they will have relatively low aircraft movements per passenger movement. The increasing hub competition also means that they will be obliged to make future capital expenditures to attract large aircraft, while running the risk that they may increasingly have to provide for smaller gauge aircraft.

### **SLIDE 3 - Major constraints on tourism: questionnaire slide**

The numbers I have just been talking about are part of a regular quarterly survey which we perform of airlines in the regions. The remainder of this presentation will cover results of an annual survey which we are just completing. We ask a number of questions of airlines, airports and of a range of tourism participants. I'm going to share with you today some of the responses from airlines and airports.

We asked all participants what would be the major constraints on tourism. We gave them the opportunity to indicate the significance of each of the constraining features by circling any of the numbers 1 - 5. An indication of 1 meant that they could consider the constraint to be very low; 5 meant that it was considered to be a very significant constraint. For the following purposes, I have excluded all those which answered 3 - as they were neither large nor small. Thus the "least significant" totals include those who selected 1 and 2 and the "most important" include those who selected 4 and 5.

### **SLIDE 4 - Major constraints - airlines (greatest)**

It is interesting to note, first of all, how the responses of airlines and airports compare and also how airline responses have changed over the past three years. I should say that we have only included airports in the questionnaire this year for the first time, so unfortunately there is no similar comparison for airports.

As you can see from the slide, easily the greatest concerns for airlines, were with external infrastructure. Hotel facilities and airport congestion were cited as the most significant constraints by over 50% of respondents.

### **SLIDE 5 - Major constraints - airlines (least)**

Of least concern to airlines was environmental issues - a somewhat surprising result given the increasing sensitivity of the airlines and tourism industry to environmental constraints. This response might in fact suggest that there is a growing industry complacency with these issues, or alternatively, that there has been a significant response which has helped to limit the potential damage of these issues. Air service levels were seen as being only a minor problem, implying their belief that there were enough air services available today. Issues such as personal security and airfares did not, the airlines considered, dissuade tourists from travelling.

**SLIDE 6 - Major constraints - airports (greatest)**

Interestingly enough, airport congestion was only the third most important constraint, with 8 out of 18 airports who answered this question believing it was a significant issue. In other words, less than half of them think this is a problem. This is despite massive attempts by some airline industry groups to raise consciousness about the anticipated shortage and therefore cost of - airport facilities.

Most of the significant constraints were considered to be external to the airports. Airlines, being responsible for constraining growth through the high level of airfares and for not providing value for money; the tourism industry for not providing sufficient hotel facilities and providing inadequate marketing and, finally, governments, whose aviation policy was seen to be restrictive. This assumption of fault being external to airports is of course a fairly natural one as there is relatively little room for airports to move in stimulating traffic growth themselves. They are at the whim of outside forces.

These perceptions are however interesting, as we can expect a more intrusive role from airports as they move into the private sector - in seeking to influence these external forces.

**SLIDE 7 - Major constraints - Airports (least)**

Airports have few concerns about economic uncertainty or investment and over 40% do not see environmental constraints as a problem. This low level of concern over the environment is perhaps more surprising than it was in the case of airlines, particularly given the high levels of concern at airport noise being directed towards airports in many parts of the world.

**SLIDE 8 - Major constraints - Airlines versus Airports**

There is a clear difference of opinion between airports and airlines about the prospective dangers of limited investor interest; a third of airlines considered this to be a major problem, while under 5% of airports did so. Other major contrasts were in the attitudes towards the effect of airfares in constraining tourism and in value for money.

### **SLIDE 9 - Major constraints - Airline trends**

With that background, it is interesting to see how airline attitudes have been changing over the past three years. It is quite evident that they perceive a growing shortage of hotel rooms; over half of the airlines questioned believe that this was a significant constraint, contrasted with under 1 in 5 who felt this back in 1993. Otherwise, most trends are towards lower significance of the constraints. Most importantly, (as noted above), not only is airport congestion seen to be a concern by only half of the airlines, there is even a suggestion that this level of concern is reducing. This is not yet a trend but it is clear that the concern is not increasing.

More expectedly, economic uncertainty has slipped as a concern from over 50% in 1993 to just over 20% in 1996.

So what conclusions do we draw from these results? There is some commonality of attitude but there is still an important tendency to allocate problems to other parts of the tourism and travel industry. There is considerable complacency over airport congestion - and therefore over the perceived need for infrastructure - and over environmental issues. There is also a clear and widespread perception that a hotel shortage is looming in most parts of Asia. This latter point inevitably also requires very extensive capital investment and therefore investor confidence. Unfortunately, however there is very little communication between the airline and airport industry and those interests which invest in hotels. Probably the most significant change in this area is the increased interest of airports in developing facilities in their vicinity.

### **SLIDE 10 - More or less airlines**

Now, I'll turn to look specifically at some airline and airports issues. In particular, how competitive will the airline market be in future?

In 1993, almost three quarters of airlines believed that there would be more airlines operating in their markets over the next 12 months (they were right!)

In 1994, 9 out of 10 believed that this would be the case. Again they were right. This year the only change has been that there is now unanimity among airlines in believing that there would be more carriers operating within the next 12 months. There is also a growing belief that there would be more carriers operating by the year 2000.



**SLIDE 11 - Airlines - next 12 months**

At the same time, every airline in this region plans to increase its route network over the next 12 months. Almost all of them will increase their fleet size during this period and, without exception, the airlines anticipate that they will be carrying more passengers by the end of 12 months. These views have not changed significantly over the past three years and, I should say that in each respect they appear to have been correct.

In short therefore everything is growing. This is not surprising. There will, in future, be more airlines and existing airlines will continue to expand their operations for the foreseeable future.

While this seems a fairly straightforward proposition, bear in mind that the prevailing trend elsewhere in the world is towards fewer large international airlines.

**SLIDE 12 - Airlines - next 12 months**

Also, the airlines expect to see their load factors increased during this time. That is to say that they anticipate the traffic will grow faster than their increases in capacity. Over 50% of airlines still maintain in this environment that average yields will increase (although it should be noted that almost 50% of them don't believe this).

Again each of these is a possible outcome, although, given the considerable increase in the number of seats being supplied into the air and the higher levels of competition, we are starting to get into danger territory.

**SLIDE 13 - Airlines - next 12 months**

With all this additional capacity and increasing competition there is clearly a widespread expectation that there will be significant traffic growth. This explains why three quarters of the airlines anticipate they will be making profits next year. This is however down from 90% of airlines which envisaged profits back in 1993.

But, with this slide, we hit a rock. 80% - 8 out of 10 - of all airlines surveyed also believe that their market share will increase this period. This is a big ask. I believe that it not only reflects an inherent optimism but also the necessary marketing and sales attitude towards airline operations.

This aggressive phenomenon is not unique to the aviation industry. But, to take you back to comments I made at the beginning of this paper and the comments about the growing order books of the airlines, there are obviously dangers looming if traffic growth does slacken.

### **Airline alliances to meet the competition**

You will also recall that I talked earlier about the inability of airlines to respond to added competition by cross-border merges. This is because of the tight regulatory structure surrounding international airlines. Their only available response therefore is to resort to more limited forms of co-operation between airlines.

Airlines in this region have been reluctant to become involved in airline alliances to the same extent as their counterparts in Europe and North America, perhaps because of greater regional diversity and a greater sense of independence. I would also venture to suggest that a major cause is the relatively early stage of evolution of the aviation market in this part of the world, with the current very high levels of traffic growth. In other words, many airlines see opportunities for individual expansion on a very high level and do not wish to be fettered in their expansion plans by being tied to other companies.

### **SLIDE 14 - What alliances in the next 12 months?**

When we asked airlines in 1994 whether they would be developing equity relationships with other airlines, not a single respondent contemplated this in their future. As I mentioned, this was somewhat surprising and very different from attitudes in other parts of the world. (Elsewhere, the response to this question would be almost unanimous in the other direction.) However, this year 10% of regional airlines now envisage that they will become involved in equity relationships over the next 12 months.

Most dramatic has been the leap in expectations of increased code sharing from 40% to 90% over the past two years. This has proved to be a very effective form of network expansion and offers great opportunities for improved marketing, both within the region and externally.

There has also been a significant jump to schedule coordination. Surprisingly - to me at least - this jump has not been apparent in coordination on frequent flyer programmes. I expected there to have been a substantial growth in this area, particularly because frequent flyer programmes can, when co-ordinated, generate

significant benefits. At least, that appears to be thinking of carriers like British Airways/Qantas and Ansett along with its range of international partners. Likewise, Air New Zealand has linked with other carriers. In fact, less than half of the airlines responding have any joint frequent flyer programme currently in existence.

**SLIDE 15 - What alliances in year 2000?**

Again, when we look at the equity alliance expectations for the year 2000 it is clear that many airlines are now coming to see the inevitable. There has been a dramatic leap in expectations in this respect from virtually nil in 1994 to 40% this year. Not surprisingly, anticipation of increased code shares are also up. But, to my surprise again, frequent flyer coordination is expected to diminish by the end of the decade.

This, in very brief terms, anticipates the response of airlines in this region to competitive trends in the market place. I would stick my neck out and suggest that the intensity of alliance building will in fact be greater than currently expected by the airlines. Moreover, the speed of this process will increase markedly if there is any faltering of the economy in 1997 or 1998.

**SLIDE 16 - Will aeronautical charges increase?**

One final issue which is often considered a nightmare by airlines, and which relates to airport privatisation and financing. 9 out of 10 airlines and three quarters of all airports see aeronautical charges increasing in the next 12 months and by the year 2000. Again, I would be surprised if this is the case in the longer term, given the increasingly commercial approach of airports, which see aeronautical services gradually being underwritten by improved retail returns. At the same time, given these attitudes, there seems little hope of any significant reductions, with increases definitely more likely.

## IN CONCLUSION

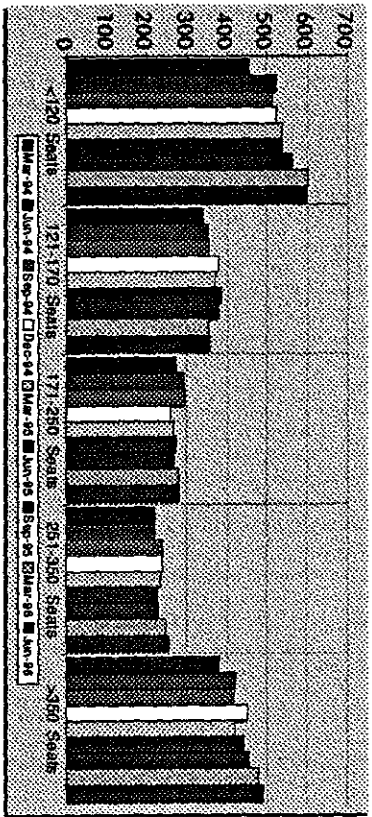
There is a good deal more in our questionnaire and a number of quite interesting different ways of looking at the results. We shall be producing a more detailed report in the near future and combining it with responses from the tourism industry, including national tourism authorities, hotel operators, tourism facility providers and wholesalers and retailers.

Meanwhile, the general prognosis on the basis of these questionnaire results is that there are considerable amounts of optimism and not a little dreaming - with the prospect of some sleepless nights over the next 3 years. For those of you who are not part of the aviation industry, I hope your dreams will one day be fulfilled. For those in the industry I hope that the nightmares will at least remain at bay for some years to come.

THE END

# AIRCRAFT IN SERVICE

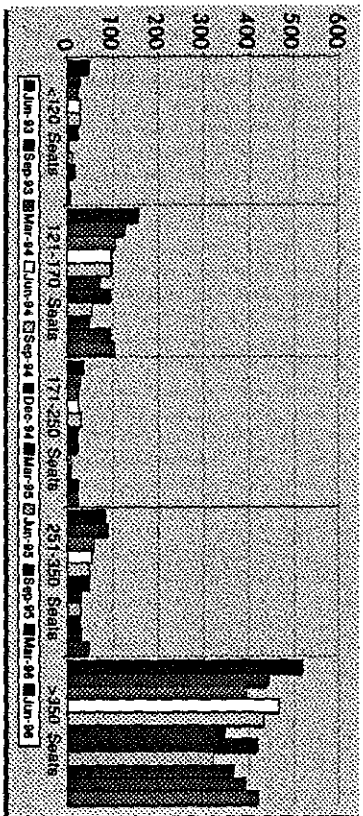
## ASIA PACIFIC FLEET DATABASE - JUNE 1998



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# AIRCRAFT ORDERS

## ASIA PACIFIC FLEET DATABASE - JUNE 1996



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# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

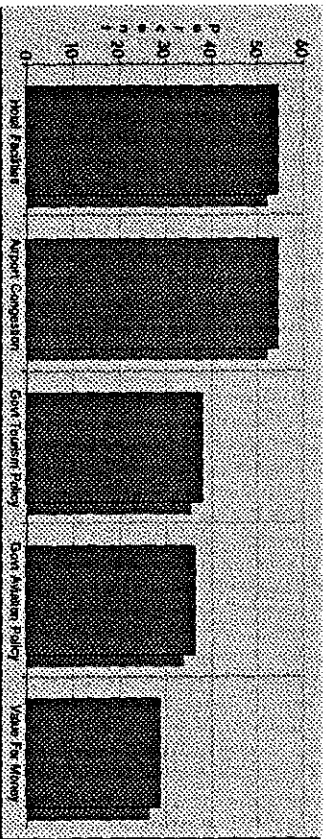
1) In your opinion, what will be the major constraints on international tourism growth in the Asia Pacific region during the next 12 months? (Please circle a number in the range 1-5 to comment - 1=no constraint, 5=major constraint)

- 1 2 3 4 5 • Hotel facilities
- 1 2 3 4 5 • Tourism support services (eg ground/podagca, shopping facilities)
- 1 2 3 4 5 • Marketing of tourism products
- 1 2 3 4 5 • Air services levels
- 1 2 3 4 5 • Airfares
- 1 2 3 4 5 • Airport congestion
- 1 2 3 4 5 • Economic instability/ investor interest (for hotels and other infrastructure)
- 1 2 3 4 5 • Government (visa/entry) policies
- 1 2 3 4 5 • Government tourism policies
- 1 2 3 4 5 • Environmental issues
- 1 2 3 4 5 • Personal security
- 1 2 3 4 5 • Concerns of tourists for "Value for Money"
- 1 2 3 4 5 • Other (please specify).....

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# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

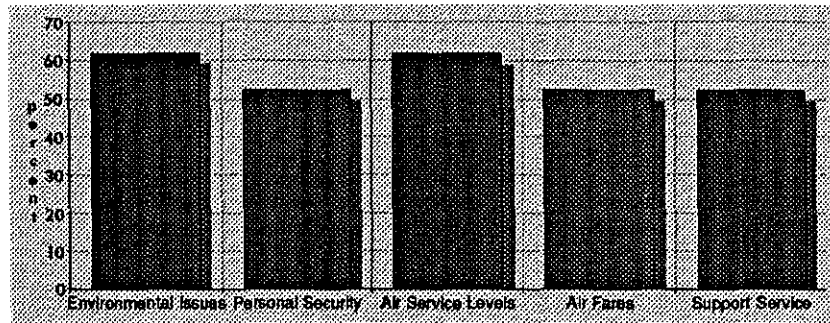
## CREATED BY AIRLINES



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# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

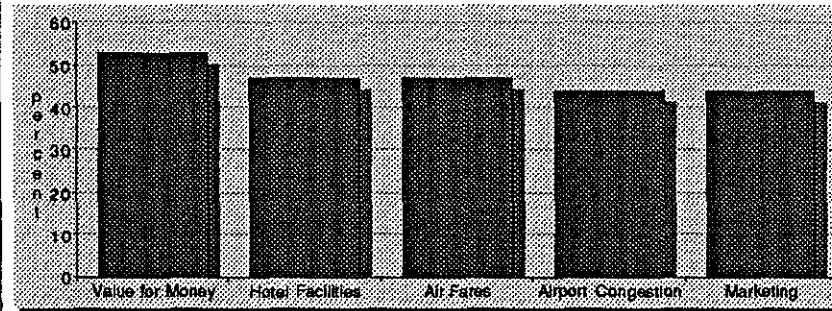
LEAST - AIRLINES



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# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

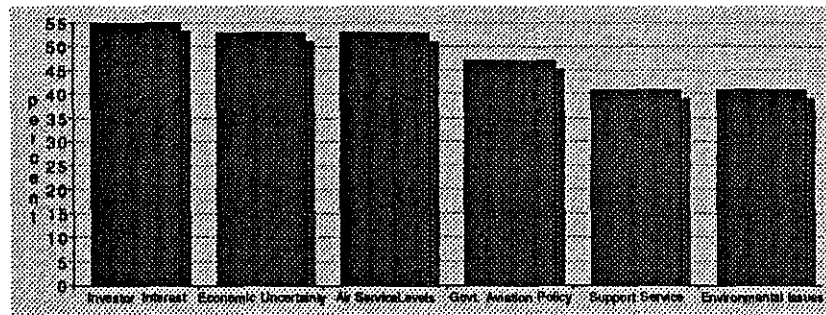
GREATEST - AIRPORTS



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# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

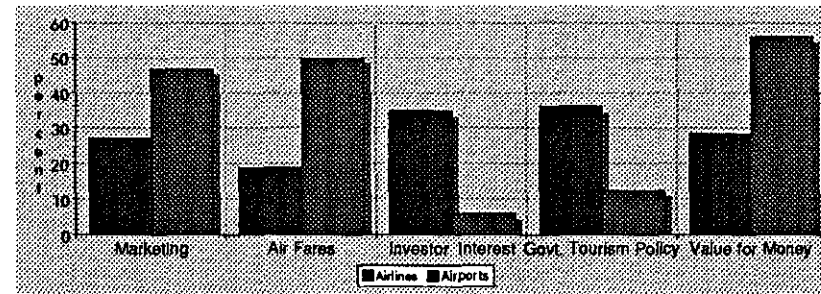
LEAST - AIRPORTS



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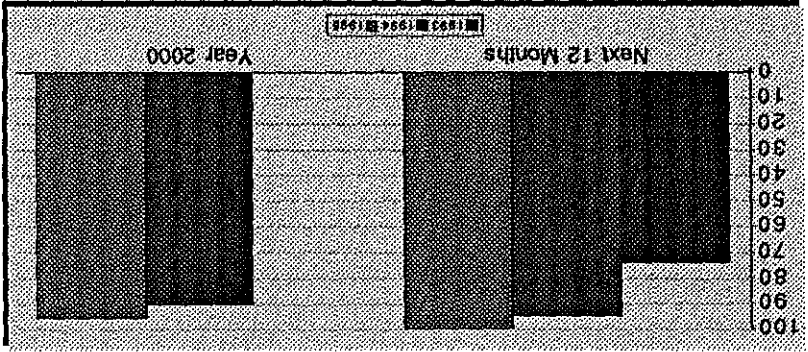
# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"

GREATEST CONSTRAINTS -  
CONTRASTING AIRLINES VS AIRPORTS

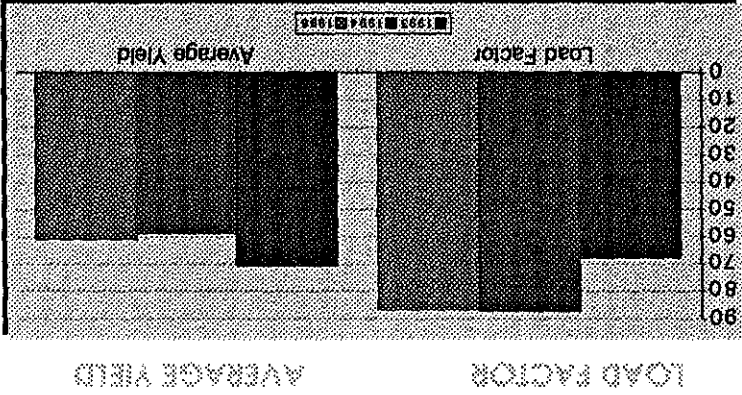


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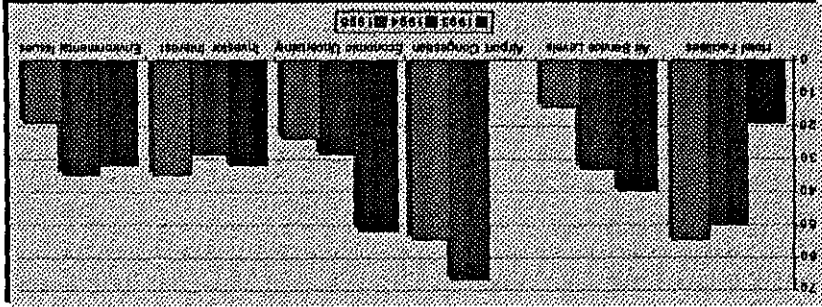
# WILL THERE BE MORE OR LESS AIRLINES OPERATING?



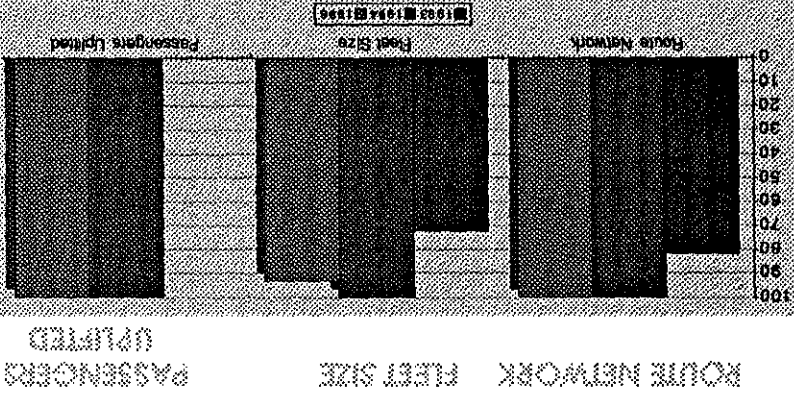
# AIRLINES : NEXT 12 MONTHS



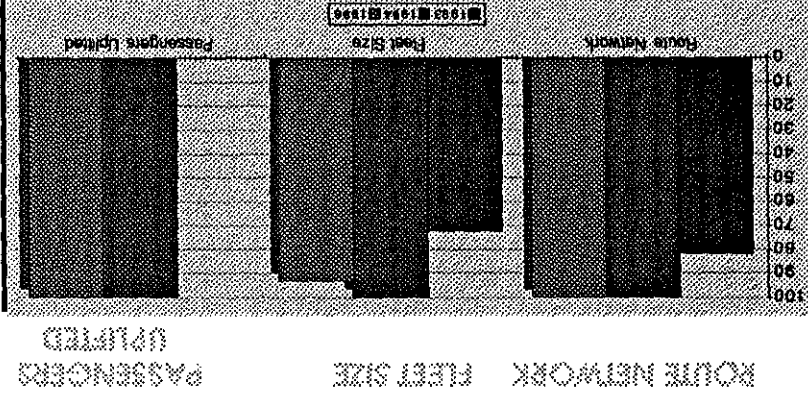
# "WHAT WILL BE THE MAJOR CONSTRAINTS ON TOURISM?"



# GREATEST CONSTRAINT AIRLINES SIGNIFICANT TRENDS 1993-1998



# AIRLINES : NEXT 12 MONTHS

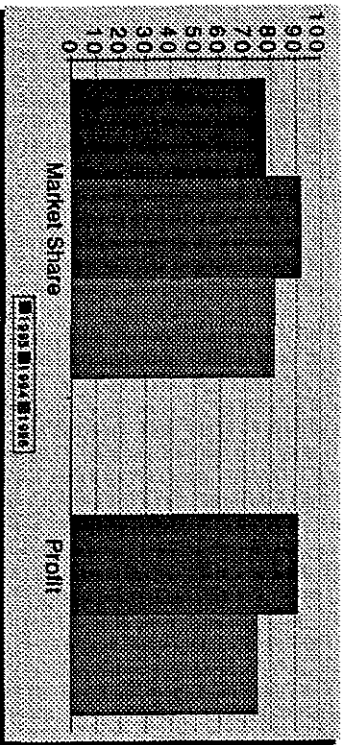




# AIRLINES : NEXT 12 MONTHS

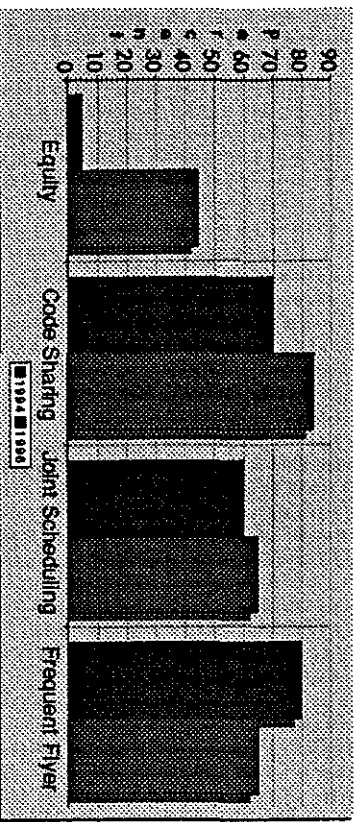
MARKET SHARE

PROFIT



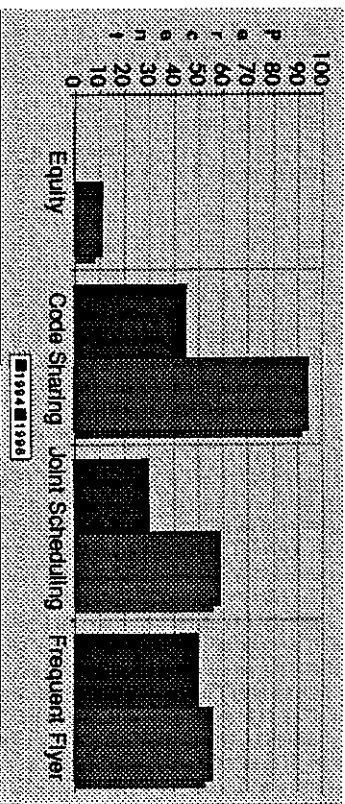
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# WHAT ALLIANCES IN THE YEAR 2000?



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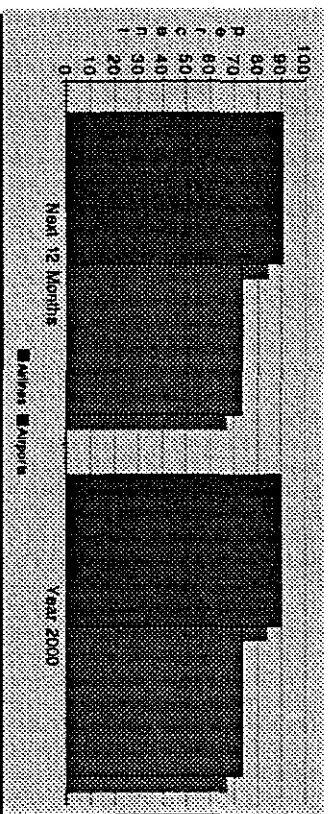
# WHAT ALLIANCES IN THE NEXT 12 MONTHS?



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# WILL AERONAUTICAL CHARGES INCREASE?

AIRLINES VS AIRPORTS



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