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A Conversation With...

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# RED TAPE





*During the past several years, the airline industry has taken several steps toward becoming a more global industry. Although progress has been made in areas such as alliances and partnerships, government regulations and other barriers still remain.*

■ By Steven D. Leonard | *Ascend* Contributor

**D**uring the past several years, the airline industry has taken several steps toward becoming a more global industry. Although progress has been made in areas such as alliances and partnerships, government regulations and other barriers still remain.

The idea of conducting commerce across a broad geography can be traced to civilizations that developed around the Mediterranean and in China as well. As goods or materials became available in one location and were in demand in another, they were transported along with the people who made the deals.

Business today is conducted in much the same way, based on supply and demand. The transportation infrastructure for people

and goods provides a similar service, if only slightly more complicated and on a different scale.

Globalization in the 21<sup>st</sup> century is an accepted reality. People move throughout a vast network of airlines to even the most remote location in hours rather than days. Entire industries have been built on transporting tourists, families and, of course, goods and materials, which are brought from multiple locations to one place for assembly or sub-assembly and then transported to markets all over the world. As population, globalization and economic well being has increased, air travel has increased at an even faster rate. Since 1970, as the world population has grown by 76 percent, air travel has grown by almost 500 percent.

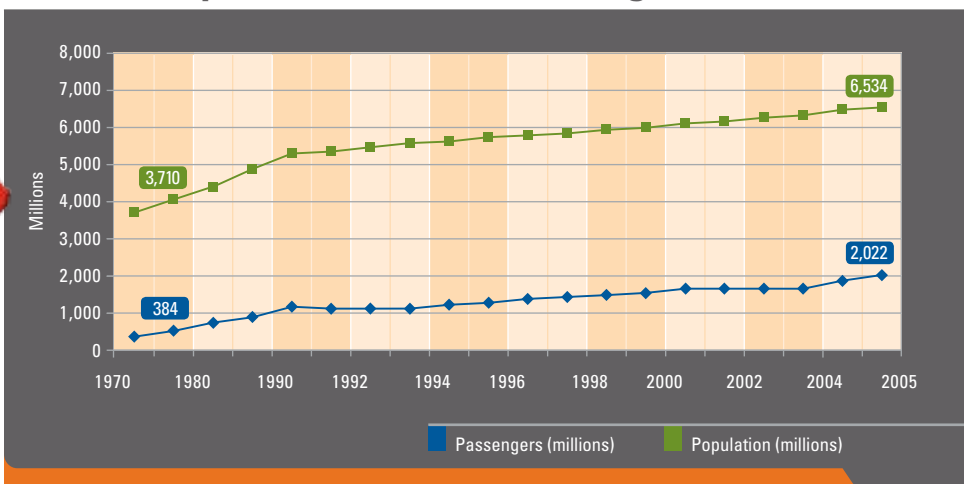
Indeed, the global airline community continues to be in the midst of unprecedented growth. According to Boeing Research, growth patterns driven by economic expansion will mean significant demand for airline capacity during the next 20 years:

- Airline passenger traffic is forecast to grow 4.8 percent annually.
- The worldwide airline fleet will double to 35,300 units.
- Almost 26,000 new aircraft will be delivered, 20,000 for growth.
- About 6,500 will replace retiring aircraft.
- The freighter fleet will nearly double to 3,500 aircraft.

### Globalization Defined

Globalization has developed because of the desire to gain from the exchange of goods and services. It has been an uneven course. Post World War II, international trade made up less than 10 percent of the

## World Population and Air Passenger Growth



From 1970 to 2005, world population increased by 2.8 billion people, a 76 percent increase, while world passenger traffic increased by 1.6 billion, a 500 percent jump.

U.S. economy. Today, that number is nearly 30 percent and still growing. At US\$11 trillion, the United States' gross national product is the world's largest followed by Japan at US\$4.3 trillion, Germany at US\$2.0 trillion, the United Kingdom at US\$1.6 trillion and China, which will undoubtedly overtake the United Kingdom and Germany within the next few years, at US\$1.5 trillion. Clearly, the definition of globalization is illustrated by the growth in China.

The airline industry has played a big part in economic globalization, but the industry itself is still largely a controlled marketplace. More than 2 billion people fly each year generating US\$29 trillion in economic value, and more than US\$3 trillion worth of cargo is flown. Without a doubt, airlines have contributed mightily to globalization in general. While many barriers have been lowered and some eliminated, airlines still operate in an environment of controlled competition. The airline industry was one of the first to conduct its business globally, but the reality of true aviation globalization has proven elusive.

There are many reasons why airlines are still not full global players. Part of it has to do with national interests and concerns about security in various countries. Other reasons have to do with the structures established after World War II that have proven slow to change. These market controls or bilaterals — agreements between countries that set frequency of flying, gateways and fares — have largely remained intact since the 1950s. Change, however, has begun bringing several benefits.

## Deregulation and Privatization

In 1978, the United States deregulated its domestic airline industry while its international markets remained tightly controlled. The International Air Transport Association set international fares and rates until 1979 when the United States withdrew anti-trust protec-

## 2005

Rank	Land	GNP*
1	USA	11,351
2	Japan	4,366
3	Germany	1,966
4	United Kingdom	1,647
5	China	1,529
6	France	1,455
7	Italy	1,212
8	Canada	728
9	Spain	655
10	Mexico	642

## 2050

Rank	Land	GNP*
1	China	44,453
2	USA	35,165
3	India	27,803
4	Japan	6,673
5	Brazil	6,074
6	Russia	5,870
7	United Kingdom	3,782
8	Germany	3,603
9	France	3,148
10	Italy	2,061

\*In billions of U.S. dollars; source: Goldman Sachs

**The growth in China's gross national product illustrates the impact of globalization. China, which currently ranks fifth among nations in GNP, is expected to have the world's largest economy within 45 years.**

tion and the U.S. Department of Transportation later withdrew supervision of fare setting — first for charters, then cargo. Pricing regulation is largely a thing of the past in U.S. international markets.

A large number of airlines throughout the world have gone from state to private control. It has been estimated that private investors now control more than 75 percent of the airline industry worldwide. The European Union itself achieved full airline deregulation for intra-E.U. service in 1998. Today, the European Union continues to press its member states to divest airlines and end subsidies, and it has also recently announced further measures. In May, according to *Air Transport World*, the European Union advanced its aim to liberalize international air transport, reaching terms with Singapore to create a single European air market by 2010. The "horizontal" agreement with Singapore, which removes nationality restrictions contained in bilateral accords between that country and individual E.U. member states, is the first the European Union has signed with an Asian country. The deal allows any E.U. airline to operate flights between any E.U. nation and Singapore, gives Singapore the right to seek further-liberalized aviation agreements with E.U. states and puts in place the framework for an eventual open-skies accord that would remove all restrictions for flights between the European Union and Singapore.

"This agreement recognizes that airlines in the [European Union] are not any longer national airlines," said European Commission Vice President Jacques Barrot. "This is an important step in our external aviation policy and particularly in our aviation relations with the Asia/Pacific region."

The common aviation area agreement represents the first steps toward a single European market comprising 35 countries and 500 million people, according to the European Union. It would extend the European aviation market beyond the 25 E.U. members to 10 additional nations comprising eight Southeast European countries, Iceland and Norway. The formal agreement follows a political agreement announced recently. The European Union has set 2010 as its goal for implementing the common aviation area, which aims to harmonize safety and security regulations and liberalize market access among the 35 nations.

Still, some countries consider airlines as state or national assets and have strict ownership rules in place. While minority ownership is allowed, operating ownership by foreign interests has not been approved. In the United States, the provision for U.S. airlines to commit to the Civil Reserve Air Fleet during national emergencies has been cited as the primary factor for limiting foreign ownership.

Cabotage, or the transport of domestic traffic by a foreign carrier, is also still an issue. This has been a means of protecting national carriers and today is a subject of bilateral agreements whereby the various freedoms allow carriers to transport traffic to, within and through other countries. Some countries believe there are good reasons to maintain current practices:

- They generally provide some stability in a very cyclical industry.
- There is the ability to declare standards for service, safety and security.
- In some countries, they help meet economic objectives, especially tourism.

Governments will continue to be strongly involved with airlines. They will want to be



Recently, Singapore reached a "horizontal" agreement with the European Union that removes nationality restrictions, allowing Europe-based airlines to fly from any European country to Singapore.



certain the changes they make are good for their citizens and will insist on the right to intervene if changes are needed. For that reason, airlines may lag other industries for many more years in reaching global operating freedom.

## The Global Economic Network

The next large-scale change in airline globalization may well be expansion of open-skies policies. Such agreements have been completed between literally hundreds of countries and include a wide range of conditions up to and including full and open competition. Many of the largest countries have resisted opening their markets in general, but there is clearly movement in the direction of more liberal agreements.

The U.S. DOT has said open-skies agreements lead to expanded demand for international aviation service and create new business for international air carriers. In addition, the U.S. DOT has argued that open-skies agreements promote increased travel and trade, productivity, job opportunities, and economic growth. They do this by reducing government interference in the commercial decisions of air carriers, freeing them to provide affordable, convenient and efficient air service for consumers.

An open-skies agreement allows air carriers designated by the signatory countries to make decisions on routes, capacity and pricing and fully liberalizes conditions for charters and other aviation activities including unrestricted codesharing rights. Open-skies policies are successful because they have gone one step closer to airline globalization. By allowing air carriers unlimited access to points in the signatory countries and unlimited access to intermediate and beyond points, such agreements provide maximum operational flexibility for airline alliance partners.

## Alliances

Alliances are powerfully dynamic forces in the global airline business. Expansion of markets and regional economic growth are driving demand for new and expanded air services. These alliances are based on mutually agreed benefits, which derive from enhanced shared revenues and lowered costs through common use of resources. This trend toward alliances has produced a competition that now includes carriers that represent virtually every region in a global expansion of networked services such as ticketing, baggage transfers and frequent-flyer mileage credits. This is all possible because alliance airlines have linked their computer reservations systems and harmonized standards.

The three main alliances — **oneworld**, SkyTeam and Star Alliance — account for 80 percent of world airline capacity as measured in available seat kilometers and include 19 of the world's 20 largest airlines, soon to be all 20 when JAL joins **oneworld** next year.

This interesting blend of competition within a region among airlines and cooperation across the broad international marketplace is based purely on economic considerations. Airline planners today use sophisticated modeling to determine the benefit from these kinds of agreements just as they plan their own networks and operations forecasting passenger and cargo loads. Technology has had the impact of helping airlines understand the global marketplace and where the benefits of operating globally can be found, including identifying partners that can add value to the networked alliance.

Not everyone agrees that alliances are good for the public because they argue the networks are not always the most efficient from a service or price level. The standards for international services that airlines created themselves through IATA permit all member airlines to publish joint fares and ticketing

as well as baggage-transfer agreements. Any IATA-approved travel agent is authorized to sell tickets on any IATA airline, including tickets at a single-through fare for a multi-airline journey. Given the focus on cost reduction by airlines today, this has become an area that airlines have sought to change. With the growing proliferation and preference for self booking and Web-based reservations, ticketing and check-in, the original

model is being replaced by one that is driven by the market. It is true that international travel is changing more slowly to the new distribution model, but the trend is definitely in that direction and is another sign that airlines have learned to use their technologies globally.

Alliances without question have moved the airline industry closer to globalization through the extension of airline networks and through the market knowledge gained from cooperation among the wide range of carriers working together. The use of Web-based tools has accelerated this trend, and the application of sophisticated fleet and network planning, modeling, and market research tools to the global marketplace has helped airlines make sound decisions about their network and their partners.

## Future Developments

In his speech during this year's IATA annual general meeting, General Secretary Giovanni Bisignani said, "An agreement between the [United States] and Europe on open skies would liberalize 105,000 seats each day and set the stage to address ownership. The European Commission is pushing in the right direction. But fear and local politics are excuses for the [United States] not to move forward. Responsible governments anticipate and lead change. The bilateral system served us well over 60 years. Now, let's organize a spectacular US\$12 billion retirement party. That is the amount of additional profit that it would add to our industry. And the positive impact on the global economy would be enormous. The wake-up call: liberalization is long overdue. And if the [United States] and Europe are not willing to maintain leadership, fast-moving India and China are not afraid to drive change."

While it is unknown which developments will shape airline practices and government policies in the future, there is strong interest in continuing to improve efficiency at airlines and in policies that allow markets to be more open to competition.

Innovation will continue as airlines apply technology and knowledge-based solutions to help make them more competitive, to extend their existing skill base and to bring about positive change in the business.

With profit as the driving motive, airlines' management has proven it knows how to make itself competitive and have overcome significant obstacles, especially in the recent past. There is no doubt that globalization will become a reality that is based on the fundamentals of sound airline management practices learned through both hardship and success. **F**

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## Airline Alliances

	oneworld	SkyTeam	Star
Countries	134	149	152
Destinations	605	728	842
Daily Departures	8,151	14,615	15,500
Passengers (millions)	258.3	372.9	425
Fleet	2,161	2,018	2,800

**The rise of global alliances represents a large step in the process of globalization of the air transport industry. Combined, the three main alliances account for 80 percent of world airline capacity.**