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A Conversation With …
Enrique Beltranena, Volaris
Chief Executive Officer
and Managing Director

Page 10.

6 Afriqiyah Airways knows when and where to expand

32 Significant improvements to air traffic control systems

80 Effectively diagnosing MRO issues and prescribing solutions

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YEAR OF THE TIGER

High-speed rail, changing consumer behavior, technology's pace of change — will Chinese airlines be like reeds in the winds of change or will they resemble mighty oaks?

By Siew Hoon | *Ascend* Contributor

An old Chinese proverb goes, "An inch of time is an inch of gold, but you can't buy that inch of time with an inch of gold."

Any international company that has ever had business dealings with China understands that to be true. To get ahead in any business in China, you have to put in the time, and you know that no amount of gold can be a substitute for that time.

Just ask those managing the biggest names on the Internet — eBay, Yahoo and Google — and they will tell you of the trials and tribulations they've had in growing their business in China.

So, it's the Chinese airline sector that continues to confound, yet fascinate, the international community — confound because it's a wonder how it operates within the legacy structures and processes and yet it does seem to work, and fascinate because those who work in China know if they put in the time and manage to get their foot in the door, they will "be in readiness for favorable winds" and eventually make their pot of gold.

So will the winds be favorable this year for the Chinese airline sector? Hope springs eternal. The image last November of China President Hu Jintao and U.S. President Barack Obama standing at the Great Wall, a structure once built to keep out foreigners and now draws them in by the millions, fanned new hopes of further liberalization of certain sectors of its economy, aviation included.

There is no doubt the world wants — and needs — a more open China to boost trade in a year that will continue to be slow for most major economies around the world.

Last year, as the world reeled collectively from the global financial crisis, the Chinese economy held its own, ending the year with a more than 9 percent growth. This year, economists are predicting close to 10 percent growth. Its gross domestic product is now more than US$5 trillion, making it the second-largest economy in the world, displacing Japan.


Photos: Jupiter

High-speed rail in China poses a threat to the country's top carriers. During the next decade, the county will build more than 18,000 kilometers of high-speed track, giving China more than half of the world's total high-speed railways and significantly impacting domestic air service.

Economists are also predicting that the major drivers of growth this year will come not only from China and India, but also the rest of the Asian region. Global companies thus know that to develop their business in the new year, they will have to put in more inches of time in the region.

Gloom Amid The Boom

Air travel is one sector that has seen massive growth in China in the past few years. According to PhoCusWright, in 1985, only 7.5 million people traveled by air in China. By the end of 2008, this figure had risen 25 times to about 200 million.

That's not to say things have been all rosy for Chinese airlines. Their problems began even before the collapse of Lehman Brothers in September 2008 and the subsequent implosion of the global banking sector.

The greatest sporting event of the century for China — Beijing Olympics 2008 — was supposed to generate great business, but it didn't materialize. Security concerns and visa hurdles kept foreigners away, including business travelers who feared the inconveniences of a trip around that period. A spate of natural disasters thereafter — from snowstorms to the devastating earthquake in Sichuan — also dampened travel demand, both domestic and international.

The result: A combined loss of more than US$4 billion by the country's three state-owned carriers — Air China, China Eastern and China Southern.

Last year, as the global financial crisis took its toll, Chinese airlines were not spared. According to PhoCusWright, China's airline market was projected to decline by 9 percent to US$22.6 billion in 2009. While passenger volumes suggest a steady year-over-year growth of 8 percent to 10 percent, the decline in premium international traffic adversely affected the bottom lines of all three airlines.

Domestic Travelers To The Rescue

But what helped was the strength of the domestic market, a major contributor to Chinese airlines' revenues. Domestic travel accounts for 60 percent of Air China's revenues, 70 percent of China Eastern's and 80 percent of China Southern's. The government stimulus package to promote domestic travel as well as its declaration to make domestic tourism a key pillar of its economy definitely helped boost numbers.

According to Xinhua Economic News, China Southern, China's largest airline company by fleet size, transported 66.4 million passengers, accounting for 28.7 percent of the civil aviation industry's total passenger volume and outperforming Air China and China Eastern Airlines. In so doing, China Southern increased its passenger transportation volume by 6.59 million over 2008.

An airline source in China told *Ascend* that domestic air travel in the country grew by 20 percent. "The environment in 2009 was definitely better than in 2008. Oil prices were reasonable and domestic demand rose."

Brett Henry, vice president of marketing for Abacus International, said that in the dark year for airlines in Asia in 2009, "the bright spot really is China.

"Chinese carriers' revenues are up from 2008 by 6 percent in comparison even as yield and average fares are down, capacity and departures are up by 15 percent and the load factor is up by 5 percent," Henry said. "Most Chinese airlines are reporting a return to profitability. It will only get better for Chinese carriers in 2010."

Rail Threat Looms

But growth notwithstanding, a new threat looms in the "Year of the Tiger" — the introduction of high-speed rail. Last December, the 1,000-kilometer link between Guangzhou and Wuhan opened, causing sleepless nights at airlines such as China Southern, which has the biggest exposure to the domestic market.

"It will be a tough year," said a Chinese airline source. "This is bad news for domestic-focused airlines like China Eastern and China Southern. It will be difficult for airlines to compete with high-speed rail."

The new rail cuts journey time between Guangzhou and Wuhan from 10.5 hours to 3 hours. Flying time is 90 minutes. Train tickets cost about 40 percent less than airfare, and train stations are more centrally located than airports and come with fewer security procedures.

The Wuhan-Guangzhou link is only the beginning of a grand plan to build more than 18,000 kilometers of high-speed track by 2020. When completed, China will have more than half of the world's total high-speed railways, which will expand the national rail network to 120,000 kilometers.

Together, China President Hu Jintao and U.S. President Barack Obama visited the Great Wall Of China late last year, giving hope to some of further liberalization of certain sectors of the Chinese economy, including air transportation.

"Wait until the link between Beijing and Shanghai opens by the second half of 2010; that's when we will see the full impact on airlines," said the airline source. "The only thing we can do is cut fares and keep our airfares at RMB300 to RMB400 (US$44 to US$59). But we have no room to control our costs such as airport service charges. In fact, this will add to our costs because we have to improve our service to compete for passengers."

This lack of ability to control costs within a regulated environment — not to mention the official intolerance of low-cost independent airlines — is one of the hurdles that stops low-cost carriers from truly taking flight in China. Other than Spring Air, based in Shanghai, which has seen reasonable success, all others including Lucky Air (Kunming), China West Air (Chongqing), United Eagle (Sichuan) and Viva Macau (Macau) have remained small and have localized operations.

Even AirAsia, which has seen phenomenal success elsewhere, has found it challenging in China. In December, it suspended its Kuala Lumpur to Tianjin route, citing low demand during the low season. The idea behind the route was to entice people who would normally fly from Beijing to use Tianjin, but schedule changes midway through the route operation made it inconvenient for Beijingers to catch a morning departure from Tianjin.

"Another reason is landing charges — that's a very significant part of overall costs — and landing charges are high in China, even in small airports like Tianjin," said the source. "This is one factor that makes it hard for low-cost airlines to really operate in China."

New International Focus: E-commerce

Given the competition from high-speed rail and other threats and challenges, what are Chinese airlines to do this year to stay afloat? Analysts expect stronger focus on the international market and increased investments in technology and e-commerce to drive more direct bookings and international business as well as maximize efficiencies and drive higher yields.

The lack of focus on yield management and revenue optimization is one key factor that affects profitability of Chinese airlines. According to PhoCusWright, airfares remain virtually the same regardless of the booking horizon. Fixed airfares have also affected consumers' buying behavior.

According to the market research company's "The Emerging Online Travel Marketplace in China" report, Chinese consumers typically plan their travel early (up to four weeks in advance), but they don't make a buying decision until the week preceding their date of travel. "The Chinese airline industry has yet to adopt principles of dynamic pricing and selling distressed inventory, accoring to the report."

The Centre for Asia Pacific Aviation, in one of its reports, stated that "for China Southern, an increasing focus on international routes is likely, with the carrier already flagging the possibility of launching more 'Air Express' services to Southeast Asia. More long-haul flying from its hubs in Beijing and Guangzhou is a natural evolutionary step for China Southern, although this will pit it against the established players in Beijing, led by Air China."

With its ranking as the second-largest economy in the world, China presents hope for a bright future for many of its businesses, including airlines. But China's airline industry is no different than in any other region ... it's a constantly evolving environment.

"The thing with the Chinese aviation sector is, you can't use normal common sense to figure things out," said a source who worked within the Chinese airline system for years. "You have to be flexible because things can change at a moment's notice."

Or to quote another Chinese proverb, "A reed before the wind lives on, while mighty oaks do fall."

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