Financial Structures in Air Traffic Management Organizations

John S. Strong
CSX Professor of Finance
College of William & Mary (USA)
john.strong@mason.wm.edu

Clinton Oster
Professor of Public Affairs
Indiana University (USA)
oster@indiana.edu

ICAO/McGill Air Navigation Conference

Montreal, September 2006

Overview

- Operating Statement Issues
- Capital and Balance Sheet Issues
- Financial Flexibility
- Linkages with Organizational Structure
- Conclusions

Operating Statement: Revenue

- Five basic models
  - Direct user charges
  - Direct user charges supplemented by other charges (e.g., fuel taxes)
  - Indirect user charges (pax fees)
  - Government fund-based (dedicated)
  - Government budgetary allocation
- Varying degrees of linkage with costs, even for user charge systems
- Blurred boundaries (hybrids)

Operating Statement: Revenue

- Other Issues
  - Can you make a profit?
  - If so, what can/must you do with it?
  - Reserves?
  - For-profit subsidiaries?
  - Revenues for other services or non-charged functions (e.g., regulatory)

Operating Statement: Costs

- Major issues are labor costs and O&M expenditures
- Productivity improvements and cost containment interrelated, with short-term and longer-term components
- Joint and common costs (allocation)
- Extent to which cost drivers link with revenue

Capital and Balance Sheet

- Access to capital markets
- Substantial value "locked up" on balance sheet
- Debt
  - Guarantees? Collateral? Form?
- Equity
  - Shareholders? Strategic investors? Acquisitions?

Financial Flexibility

- Re-thinking scenarios (stress-testing)
- Not "what if?" but "when?"
- Debt
- Equity
- Regulatory environment
- Governance structure

Two Examples

- NAV Canada
- NATS (UK)

NAV Canada

- Created 1996 in context of congestion, delays, budget problems
- Support of airlines, unions, pilots
- Non-share capital corporation
  - Not for profit
  - No shareholders
  - Board of directors (15)
    - 10 by airlines, business aviation,labor, govt
  - Stakeholder model

NAV Canada Post 9/11

- Traffic and revenue decline 10%
- C$ 145 m deficit vs. budget FY 2002
- Forecast 2002-05 cumulative revenue gap C$ 360m
- "Balanced approach"
  - Drew down rate stabilization fund to (C$116 m) by Aug 2003
  - Rate increases: 6% 2002, 3% 2003
  - Cost reductions salary, board, suppliers
  - Wage freeze
  - Reduced annual operating costs C$100m / year (vs. 1996)
  - Reduce and defer capital spending
  - Lease/leaseback of C$ 600m assets
- Eliminate cumulative deficit over 5 years

NATS (UK)

- Restructuring context 1990s
  - Rising operational and capital pressures
  - Budgetary needs of government
  - "From privatisation to PFI to PPP"
- "Regulated private corporatisation"
  - 46% Airline Group; 5% labor; 49% govt
  - RPI – 4,5,5 %
- Govt proceeds £800m
- > £730m debt at inception
- Project finance structure
- Born April 2001

NATS (UK) Post 9/11

- "Do-Over"
  - Bank debt from £ 730m to £ 600m
  - £ 130 in new shareholder capital (from BAA plc and HM Govt)
  - Regulatory asset base +12%
  - RPI – 2
  - Traffic volume risk-sharing
  - Suspend £ 1 billion investment program
    - Scottish Centre at Prestwick

Financial Performance and Organizational Structure

- Different financial structures can be used with different organizational and ownership models
- Some are better "matches", but even these have potential weaknesses
- Starting points matter – a lot
- Expect systems to evolve over time (not just one-off reforms)

Tentative Lessons

- User charge systems tend to evolve toward more user input and governance
- Capital investment problems in government organizations have as much to do with procurement and politics as money
- Cost containment harder under government revenue structures

Tentative Conclusions (cont'd)

- The textbook doesn't strictly apply
  - Role of Debt
  - Role of Equity
  - Flexibility, contingencies, and public service aspects
- Legacy issues
- Longer-term transitions
- And…"why do we need to do anything at all?"