



***Aviation in Transition:
Challenges & Opportunities of Liberalization***

Session 7: The Future of Liberalization

The Perspective of a Medium-sized Airline

Presentation by:
José Guedes Dias
Vice President External Relations
TAP Air Portugal

Seminar prior to the ICAO Worldwide air transport Conference

Session 7 – Topic: The Future of Liberalization

The Perspective of a Medium-sized Airline

TAP – Air Portugal

Montreal, March 23rd, 2003

What does Liberalization really mean to us

1. In relation to the aeropolitical environment in which we do business

- Freedom for carriers to provide services on desired routes, operating at an economic and commercially reasonable scale
- Freedom for carriers to access new resources and to join forces with each other, regardless of nationality
- Freedom for Passengers to choose among alternative services

2. In relation to suppliers of means and infrastructure and product distributors

- Freedom for carriers to choose how and with whom best to do business or, where that is not attainable, to be able to secure from providers and distributors an adequate correlation between service level and price to be paid

Whereas the first group of freedoms can be and has, in some regional markets, been partly achieved, there is still a long way to go in terms of the second, where natural monopolies such as airports and ATC, or oligopolies such as GDS's are still ripping the benefits of their strong market power, freely charging prices which are overblown by inefficient structures.

Why we think Liberalization is needed

- To end monopolistic situations where insufficient numbers of operators and/or suppliers provide a less than satisfactory level of service
- To allow fair and sound competition, that can work as a stimulus for inefficient service providers, as they run the potential risk of substitution
- To allow more flexibility in terms of resource sources and utilization (route & frequency planning/fleet allocation), thus creating ways for the reduction of fixed costs and enhanced economies of scale, density and scope

How we see Liberalization should be pursued...

1. In relation to the aeropolitical environment in which we do business

- Liberalized environments induce reduction of costs, but also of yields
- Evolving situation needs Governments monitoring
- A balance between Liberalization and Sustainability must be stricken.

Market Access

The past has shown us that with full blown deregulation and because of the easiness to set up a new airline (everything can be outsourced – from planes, maintenance, handling, to even staff and capital...) there is a tendency to excessive fragmentation, leading to excessive capacity, leading to insufficient profitability, leading to the restructuring or demise of carriers and eventual consolidation. One can argue that much is gained by this natural “fighting-for-survival” cycle, as only the well fit will endure. But, if inadequately supported by consistent regulatory policies, such cycle can also easily lead to a final playing field that is less healthy and competitive than the starting configuration, at the high cost of investors’ time and capital and huge numbers of jobs extinguished in the process.

It may, then, be the case that the opening up of market access should be gradual and regionally customized, to allow local carriers to prepare their business models for the new environment, for instance, by differentiating their product or specializing in niches where they are certain to outperform others with their unique know-how and competences...

But such pace ought only to be acceptable, if not taken at the cost of the interests and needs of existing traffic demand!

Experience shows that countries with a more restrictive or protectionist approach to market access by other national or foreign carriers have been less capable of attracting foreign investment and developing their aeronautical infrastructures. The way forward is never to sacrifice (traffic) development to the whims of an inefficient local carrier, who if forever protected, will hardly develop the vision to reinvent itself and align its structure with market needs, as required by a competitive environment.

Capital access

Even if cross-border merger and acquisition processes in the Airline Industry are bound to encounter other type of difficulties (intercultural management, national pride, different traffic needs, etc.), most airlines around the world feel cash-strapped at times of crisis (when revenues don’t flow in quickly enough to allow them to comply with immediate payment obligations) and need to be able to open up substantial parts of their stock to any interested investors around the world.

This could be facilitated through the adoption of a less restrictive ownership clause, such as the one IATA is now putting forward to ICAO.

How we see Liberalization should be pursued...

2. In relation to suppliers of means and infrastructure and product distributors

➤ Liberalization must aim at creating fairer and more balanced gain distribution among business partners

Airlines have been able to reduce the few costs under their control impressively in recent years, stimulated both by competition of LCC and tragic events, with depressing effects on demand and yield. Doing their homework, they were able to increase the efficiency of their resources, though not to improve their contribution margins. Consumers have constantly benefited from these initiatives, which unfortunately are not replicated by other economic agents in the value chain, still capturing, through their monopolistic structures, much of the consumer surplus and airlines' efficiency gains. In fact, while airlines lower their fares to stimulate demand, others in the value chain do not refrain from increasing charges to counter any decrease in the number of movements...

Liberalization is, in this case, called for at a much faster pace. Where it cannot be achieved, preventive regulation to counter dominant position behavior, such as abusive charging, must be in place, in order to allow airlines to deservedly profit more in return for their, not always recognized, efforts to cut controllable costs, and also to stimulate Airports, ATC, Distributors and other infrastructure and service providers to become more efficient in their structures, lower their charges, and thus free their direct customers - the airlines - of their profit captivity.

If in some instances airlines are, by themselves capable, of devising creative and valid alternatives to curtail costs - such as new ways of distributing and marketing their product or of acquiring fuel by hedging -, in most cases Government intervention will be needed to free them from arbitrary price making and unacceptable burdens.

➤ Liberalization must go hand in hand with international air policy convergence

Airlines often have to face contradictory regulations – see the recent example of PNR access requirements in the US, versus Data Protection obligations on the EU side –, which add to their woes and procedural costs, not to speak of the discrimination they produce, when, for instance, different types of Security, Insurance Coverage or “Government Relief” measures are adopted in different parts of the world, imposing considerable discrepancies of treatment and incurred costs.

The myriad of taxes that are levied by governments through airline tickets is also a real proof of the work that must be done in convergence, if Liberalization is to work out as a way to create an international level playing field, freed, as much as possible, from national discrimination, and based more and more on the sound principles of reciprocity, equal treatment and fair opportunities, allowing airlines to conduct their worldwide activities in a profitable manner.

In a time of financial turmoil, retreating demand and downward spiral of yields, Governments must recognize what full-service airlines have done so far to sustain their business, where their limits to influence forces beyond their control lie, how time has arrived for others to be called in for their positive contribution to a stable and balanced Aviation Industry.

By liberalizing where excessive market power is still the norm, or surgically regulating where no valid alternative exists to natural monopolies, by liberalizing where anachronistic restrictions still prevent airlines to access and make full and efficient use of resources or take full advantage of market potential, Governments around the World will be investing in the health of an Industry crucial to the development of their peoples' wealth and well-being and a vital pillar of today's global economy.

Thank you for your attention.

José Guedes Dias

TAP Air Portugal

Vice President External Relations