Presentation by Mr. James Cherry
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Ladies and Gentlemen,

I'm very pleased to be taking part in this discussion on the role of the airport manager in preparation for ICAO's Conference on the Economics of Airports and Air Navigation Services (CEANS).

The subject on today's agenda is the economic performance of airports. But we all know that the real issue is lurking in the background, namely the charges that airports levy on airlines and their passengers.

It's an important subject, and one that I'm prepared to discuss as openly as possible. But it's interesting that this subject seems to resurface on a cyclical basis every time the aviation industry runs into headwinds.

That being said, my goal today is to review with you how airport managers can better perform their role to the benefit of all stakeholders… and all the time.

Evolution of airports

The airport sector has evolved significantly over the past few decades. It's imperative to take account of these trends in our discussion.

Not so long ago, the dominant model consisted of airports that were owned by the government and managed by a government body. Today, we have many models: airports that are entirely public; airports that are fully private; public airports that are managed by private companies, etc...

Today, we find a large number of non-government airport managers, including about 20 that are publicly listed. For example, Fraport has become a true multinational, present in Germany, Bulgaria, India, Turkey, Egypt, Peru, Senegal and Saudi Arabia, among others. Macquarie Airports has investments in Australia, Europe and Japan.

In the United Kingdom, BAA, the world's largest airport operator whose capital is now closed, is owned by an international consortium headed by a Spanish company, Ferrovial. The consortium also includes the Caisse de dépôt et placement du Québec (incidentally, this same company manages my public pension fund!). I will talk more about BAA a little later in my presentation.

You may also be surprised to learn that airports in Beijing and Shanghai are managed by companies listed on the stock exchange. In Eastern Europe, privatization is also a trend.

Somewhat curiously, in the United States, a bastion of free entreprise, the big airports are still largely publicly-owned. For example, The Port Authority of New York and New Jersey is a bi-state agency that manages, among others, three large international airports: JFK, La Guardia and Newark.

In Canada, we have a unique hybrid model. The Canadian government remains the owner in terms of assets but the management, operation, development – and financing – are the responsibility of non-profit, community-based organizations created especially for this purpose.

So, we have come a long way from the old government-owned-and-run model. Privatization and foreign ownership have become widespread realities.

Diversification of revenues
I would add that regardless of the ownership model, airports behave like any normal business and try to maximize and diversify their revenues.

According to a study by the Airports Council International (ACI), non-aeronautical revenues count on average for about half the total revenues of large airports. These revenues come mainly from restaurants and boutiques and other retail concession, parking, car rental services, land and building leases, the sale of advertising space, as well as a host of other diverse activities.

In some cases, the proportion of non-aeronautical revenues can reach 70% or more. Some airports have become veritable shopping centres and some airports aspire to become quasi cities. This is very important when talking about the profitability of airports. We need to determine where the profits come from.

Aeronautical operations generally do not produce high operating margins. Airports firmly oppose subsidizing aeronautical operations with non-aeronautical income. However, in many cases they actually do just that, directly or indirectly.

Non-aeronautical profits get reinvested in airport infrastructure, which benefits users and their customers. Higher profits make for better credit ratings, hence cheaper credit and lower cost of debt, resulting in a lower cost base to be recovered.

I'll let you in on a little secret: at Aéroports de Montréal, we don't make a cent of profit with the airlines! We don't even recover our aeronautic costs. And the agreement we have signed with our carriers won't allow us to do so for another… 10 years. So no air carrier can complain about paying overly high charges in Montréal!

Competition
Another deeply-rooted notion is that airports are monopolies… at least for aeronautical activities. It's true that most cities have only one airport and where there is more than one, these are often managed by a single administration.

Nevertheless, it's important to note that there is direct competition among airports for international transit traffic. For example, the large European hubs such as London, Paris, Amsterdam and Frankfurt, to name just a few, vie fiercely among themselves to attract this traffic.

In fact, connecting traffic is far from being protected turf: it's up for grabs! Just look what's happening in Dubai, where the government is building the world's largest hub with a capacity for 120 million passengers and 12 million tonnes of cargo.

Airports may also compete for local traffic. Let me remind you of the special situation that exists in Canada. Airports in the southern part of the country face competition from airports located just on the other side of the US border. A powerful example is Plattsburgh Airport in New York State, one hour by road from Montreal, which openly positions itself as Montreal's airport in the United States!

The drastic increase in competition in the airline industry over the past decade has also left its mark on the airport industry. Airports today face significant pressure from individual airlines with high market shares, airline groups and alliances and low-cost carriers. They are also dealing with rapidly changing business models, consolidation and, last but not least, passengers who have more choices, either on points of departure and origin or where to connect.

The quality of an airport has emerged as an important criterion in passenger travel planning. Customer satisfaction, which has become a key performance measure for airport management, is closely watched by governments and the public. More than ever, airports are courting airlines for new routes and putting themselves under pressure to be efficient with high standards of aircraft and passenger operations.

Capital intensive

This being said, the airport business is such that fly-by-night operators are pretty rare. The entry obstacles are significant. It is a highly capital intensive sector. Governments know this well; that's why most of them have privatized their major airports.

In 2006 alone, the airport industry invested almost 40 billion US dollars in new infrastructure, providing the foundation for the future growth and efficiency of the global aviation industry. Such investment would be unthinkable if the airport industry were not profitably generating reasonable rates of return.

Airports need to plan with at least a 10-year, if not 20-year, horizon, depending on the length of the planning and construction process. They also have to look at the bigger picture, beyond individual users.

We need to build for the future, based on the best possible traffic growth forecasts, but upsets are always a possibility. Mirabel Airport is a good example. The Canadian government built this airport in the early 1970s, when Montreal was the gateway to Canada for trans-Atlantic traffic. But the arrival of long-haul carriers changed everything, as did a number of other unforeseen factors. Today, as a result, this airport is closed to passenger traffic.

Also, airports are not immune from risks associated with the business of air transport. An airline can change routes and move aircraft quickly around a variety of airports, or it can shut down business altogether. Since we have no contractual relationship with airlines, at any time, this can translate into significant business risks. Pittsburgh Airport, for example, had a very bad surprise in this regard after having invested to accommodate an air carrier which said it was interested in establishing its hub at the airport. Luckily, this type of situation is fairly rare.

Performance indicators

Given all this, if you asked me what is the best performance indicator for airports, I would quickly answer: EBITDA (earnings before income tax, depreciation and amortization). EBITDA is, for capital intensive companies, the best indicator of their capacity to meet their financial obligations, especially interest payments on debt. This indicator is of special interest to lenders and credit agencies.

As for net profits, they are perhaps significant for publicly-listed airport managers. But for the majority of airports, the concept of net profit does not apply. In Canada, airport administrations are non-profit organizations and any operating surplus is reinvested in the business.

Another indicator that airport managers use in their management is cost per passenger. It's important to monitor this indicator over the years to control the growth in costs. But this indicator should not be used for benchmarking purposes since a large number of variables can influence the cost per passenger. It can vary greatly depending on the volume of traffic, the type of traffic, the quality of facilities, the level of service offered, the cost of manpower, socio-economic contributions, safety and security requirements, weather conditions, etc.

Relationship between costs and charges

Now this begs the following question: what should be the relationship between costs and charges? User charges are instruments whose purpose goes beyond mere cost recovery or return-on-investment generation. They have evolved as effective tools to attract and steer traffic at airports and to spread risk between the operator and the user. Examples are start-up aids, volume discounts, peak pricing, lower levels of passenger service charges for low cost facilities, as well as shifting charges away from aircraft-related charges to passenger service charges.

Like any normal business, airports that offer a competitive advantage are in a position to demand higher charges. For example, airlines should expect to pay a premium in order to operate at a choice location, especially when capacity is deficient.

Also, airports are entitled to some degree of flexibility in modulating charges, for instance, in order to increase investments. And it should be noted that a divergence from the principle of strict cost-relatedness can benefit the users as well as the providers. However, such divergence is permissible only as long as it is transparent, does not unduly discriminate between users, and any under-recovery of cost is not imposed on other users.

At any rate, airport charges have proven to be very reasonable over time. The fact of the matter is that, according to recent ICAO data, airport user charges have remained stable below 4% of overall airline industry operating costs.

Other indicators

Apart from EBITDA, profits, costs and charges, we can think of a host of other performance indicators in diverse areas such as customer service, operational efficiency, safety and security, to name a few.

To this I would add other indicators linked to sustainable development. In contrast to airlines, airports are rooted in communities to which they are accountable. We have economic, social and environmental responsibilities towards these communities.

I think I've landed on a critical issue here. Our stakeholders include not only airlines and their passengers, shareholders and lenders, but also local governments, socio-economic players such as chambres of commerce, and citizens' groups. When airports report on their management, they must do it for all of their stakeholders.

Governance and transparency

This brings me to the last point of my presentation: governance. First off, I have to say that I believe good governance is a winning condition for ensuring the long-term success of any company. This seems obvious to me. Poor governance leads more often to inefficiency and sometimes even bankruptcy.

Good governance implies consultation with stakeholders. Consultation is part of the habits and customs of airports, at least in Canada. I sincerely believe that Canadian airports consult their stakeholders more than any other type of company.

At Aéroports de Montréal, for example, our board of directors is composed of members from three levels of government as well as community organizations, including the Chambre de commerce du Montréal métropolitain. We report to these organizations individually in addition to publishing an annual report and holding an annual public meeting.

We have a community consultative committee, composed of 20 members from different socio-economic and community organizations, which we consult on every major issue.

To this add a host of consultative and coordination committees, including one that brings together all operators at the airport and another one just for airlines. We also consult various groups on specific issues, such as any change in land use, for example.

Airplane noise is a major issue for residents living near airports. The management of this airport soundscape requires transparent communications and permanent consultation mechanisms.

In most countries these days, the construction of a new runway in an urban area cannot take place without a long process of consultation, and sometimes mediation. For example, some 70,000 individuals and organizations took part in consultations related to the building of a third runway at Heathrow. In the case of Vienna, the mediation process for the third runway project lasted five years!

Government intervention

If you ask me what I think about the notion of increased government intervention in the business of airports, I would answer: We don't need it!

Government is already very present as a legislator and regulator. It has withdrawn from the management, operation and development of airports. Why then open the door to greater state intervention, direct or indirect, in our business? After all, we operate in a competitive environment, just like airline companies, and we must have all the latitude necessary to efficiently carry out our role and adapt to changing business conditions.

In particular, airports should not be subject to blanket regulation prescribing various levels of user charges. Airports have become very diverse, and operate under diverse conditions. A one-size-fits-all approach, as suggested by some, surely does not apply.

Assuming that market forces work, governments should only oversee their national airport industries within their national legal framework. Further intervention should be on a case-by-case basis, for example, if an airport is abusing its dominant position.

Governments have the right to decide which form of economic oversight they want to apply. They also decide whether the existing legal framework (e.g. competition law) is sufficient to eliminate risks, or whether more specific measures are required.

That being said, I find it difficult to believe that the proposed break-up of BAA in the United Kingdom, i.e. the forced sale of two of the three big London airports, will improve the situation for airlines and passengers. The problem over there is basically a lack of capacity. I really don't think that the recommendation of the Competition Commission will speed up the construction of new capacity in London. On the contrary. The timing of this so-called reform is very poor and will only complicate and delay things. But fortunately this is a very special situation.

Returning to the main subject of my presentation, the best way for airport operators and users to avoid excessive regulatory intervention is by actively engaging in a consultation process, which is either voluntary or made mandatory by the state as an alternative form of economic oversight. But, at the same time, like any normal business, airports should have the final say.

At this conference, ICAO will seek to provide more guidance on the consultation process to promote good relations between providers and users. These are important for the effective development of air transport.

Conclusion

In summary, airports are vital players in their local communities. They are essential for business, tourism and economic development. It's partly for this reason that they must remain profitable and be able to play their role at all times, even when the air transport industry is experiencing problems.

The airport industry faces many challenges, including providing capacity for air traffic that may double over the next 15 years. They will need to expand and build quickly to meet this anticipated increased in demand.

However, as we know, many factors can slow down the approval and development process. The basic question to be asked is: how can governments and the industry create a framework that is conducive to expansion and the building of new airport infrastructure?

The answer is simple: keep airports profitable, do not over-regulate them and promote good relationships between airport operators and users to avoid conflicts that could result in further delays. We need to all work together to make this happen. Thank you