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A critical evaluation of general morphological analysis as a future study methodology for strategic planning.

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Abstract

To achieve optimum results business leaders need to focus substantial resources towards developing a long term business strategy. However through a constantly changing business environment, leaders have to continuously review and adapt this strategy to meet new demands and challenges.

Regulatory change has a major impact on business, as regulation serves as the convergence touch point between business and government, and this dimension has been identified as the number one contributor to business uncertainty. To meet this challenge business needs foresight and a knowledge of the future in uncertain times best achieved through the undertaking of future studies.

There are many methodologies to undertake a future study, each with its own strengths and weaknesses. General morphological analysis was identified as a method which through its specification and design is an ideal candidate through which the complex and uncertain regulatory future could be thoroughly investigated. This studies aims to critically evaluate the robustness and appropriateness of general morphological analysis as an aid in strategic design when dealing with regulation, regulatory change and regulatory uncertain.

The methodology was thoroughly evaluated through the undertaking of a general morphological analysis of the airline industry. Through interviews with airline c-suite executives and senior consultants to the industry, dimensions affecting airline future states were identified. Through this process a likely future for the airline industry relating to the regulatory environment was described, specifically highlighting ownership and route access as dimensions of primary impact and uncertainty. This report was presented to the airline executives and consultants who assessed the report to evaluate the methodology.

83% of the executive and consultant feedback found that the report produced using general morphological analysis would be accurate. Further they found that through the process; strong, in-depth and thorough insight was uncovered. Two thirds of the expert respondents stated that they would now consider utilising general morphological analysis in their organisation as a strategy planning tool going forward.

Keywords

General Morphological Analysis, Future studies, Regulatory reform, Long-term strategy.

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Simon Swanich

10 November 2014

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Chapter 1 – Introduction to the research problem

1.1. Introduction

Business leaders around the world allocate substantial resources towards designing, adapting and implementing the best possible strategy for their business, however, all of these strategies are limited by the ever-changing regulatory framework of the organisations' operating environment (S. S. Glenn & Malott, 2006; Varum & Melo, 2010).

"Regulations shape the corporate environment and have a crucial effect on prices, factor costs, growth in demand, industry competitiveness, R&D progress, and the commercialization of new technologies" (Marcus, Aragon-Correa, & Pinkse, 2011, p. 5). However the regulatory environment is in constant flux as policy makers seek to meet their ever-changing objectives (Baldwin, Cave, & Lodge, 2012), in fact research suggest that such uncertainty is growing (Marcus et al., 2011), and such uncertainty is the leading problem facing business ("American idiocracy," 2011). In developing their organisations strategy, business leaders attempt to anticipate future regulatory changes, their competitor's responses and then pre-emptively adapt future iterations of their strategy.

To better anticipate the future, various future study planning methods are employed (Varum & Melo, 2010). This study evaluates the appropriateness and robustness of general morphological analysis as a future study tool to aid organisations during the design of their strategy(ies) in response to an ever changing environment.

1.2. Research motivation

In planning and strategising to optimise the outcomes and performance of an organisation, the world's leaders, both business and political, need a methodical process that can be utilised to envisage a likely future world. The knowledge and understanding of what is likely to occur in the future, helps leaders to make informed judgements based on an uncertain tomorrow.

However since the early 2000's there has been an ongoing debate in the 'Futures' literature surrounding the real world applicability of future studies. For instance, there have been numerous issues raised surrounding the "fragmentation of future studies and the lagging discipline building process" (Burt & Van der Heijden, 2003, p. 1012). Further, the ability for users to make decisions and contributions from the future study findings was questioned.

The motivation of this study was to identify a method of making informed and sound judgements based, in part, upon an uncertain future and to evaluate its applicability and robustness in the real world business environment. During the initial stages of this research the global airline industry was identified as a suitable case study for this evaluation, as major regulatory changes the effects of which, and the response by industry to these changes are not understood at present.

1.3. Future Studies

Future studies, which is also commonly referred to as scenario planning, is an organised approach of interpreting known data, both qualitative and or quantitative, into an understandable expectation of the future. Embarking upon a future study best supported the outlined motivation of grappling with the variables and parameters that would ultimately drive the direction and strategy of the airline industry of tomorrow. No future study can claim to be accurate, however if well executed can aid organisations to identify and minimise threats, whilst simultaneously highlighting opportunities all of which aid decision makers in making better informed judgements, despite the uncertainty, for the best possible outcome (Varum & Melo, 2010).

While there are many approaches to embarking upon a future study, one methodology, namely the Royal Dutch Shell/Global Business Network (GBN) matrix approach, created by Pierre Wack in the 1970s has been adopted by most future study practitioners. This methodology is an excellent technique (Bishop, Hines, & Collins, 2007) and in fact it is referred to as the "gold standard of corporate scenario generation" (Millett, 2003, p. 18). However there are two key downsides to this approach, firstly the Royal Dutch Shell/Global

Business Network matrix approach despite global praise does have weaknesses and drawbacks. Secondly through the global reliance on the Royal Dutch Shell/Global Business Network matrix approach, most practitioners are not taught nor do they even know of the existence of the other methodologies available to them. These methodologies all have pros and cons, comprehensively analysed in chapter 2, but are mostly ignored by practitioners (Bishop et al., 2007).

1.4. General Morphological Analysis

Through thorough investigation, general morphological analysis was identified as a prime candidate for evaluation. It is tailored to studies that must include complex policy change, and strategy alignment, both of which are relevant to the airline industry at present.

If through careful application it can successfully demonstrate a likely future scenario it would prove that business could rely on it as a structured and methodical future study technique capable of steering strategy design in a meaningful way. The technique has already been proven to be successful in developing multiple governmental policies by the Swedish Government (Ritchey, 2011c)

Ritchey (2009) defines general morphological analysis as "a method for rigorously structuring and investigating the total set of relationships in inherently non-quantifiable socio-technical problem complexes (Ritchey, 2009, p. 1)". He identifies the following analysis as being prime candidates for this methodology:

- Developing scenarios and scenario modelling laboratories;
- Developing strategy alternatives;
- Analysing risks;
- Relating means and ends in complex policy spaces;
- Developing models for positional or stakeholder analysis;
- Evaluating organisations structures for different tasks;
- Presenting highly complex relationships in the form of comprehensible, visual models.

When used in strategy formulation two complementary morphological fields must be formulated. The first contains inputs that can be controlled through the actions of management. The second indicates different projections of future operating outcomes to which management has no or only limited influence.

When compared to other approaches, morphological analysis has numerous advantages over other methodologies, for example it identifies new relationships which are often overlooked when using another less structured method (Ritchey, 2009).

Secondly, through the process of morphological analysis concepts that are not correctly and thoroughly cross-referenced are identified and removed as they have no effect to the paradigm, and absence of overlooked concepts that are material in cause and effect are highlighted and included.

Most importantly the advantage with the greatest impact is the generation of an audit trail, which allows for the reproducibility of results at a later stage.

1.5. Case Study

To comprehensively test the methodology a case study was undertaken. The author employed General Morphological analysis in the same way a consultant to the industry would. The research design included selecting an industry, arranging interviews with CEO's, experts and other consultants, applying the general morphological analysis method and then analysing and compiling the data into a written report (Annexure 1) which the participants would peruse and critique to validate the appropriateness and robustness of the method (Annexure 2).

The airline industry was selected as it is a mature industry (Aharoni & Noy, 2012), serving a highly commoditised product (Bieger & Wittmer, 2006) but unlike other mature, commoditised industries it has been prevented from globalising as a result of antiquated from post World War Two regulation. Governments worldwide either prudently or foolishly view an airline as a key strategic asset not only in developing a national agenda, but as a strategic military asset in times of war (Chang, Williams, & Hsu, 2004).

Due to this extremely onerous operating regulatory environment it has limited scope for differentiation (Aharoni & Noy, 2012). This has led to a market dominated by fierce competition (Morrish & Hamilton, 2002), with very small margins and in many cases financial losses (Bieger & Wittmer, 2006).

The airline industry has undergone very limited deregulation in recent years, but further deregulation is forecast with vastly divergent views of the likely trajectory of airline strategy in lieu of this envisaged deregulation (Iatrou & Mason, 2009).

Addressing these regulatory issues is critical to both the state and the industry. These airline regulatory issues are currently topical and feature in the popular press (Annexure 9.5). Failure to adequately address this issue could result in long term ramifications to the sustainability of many airlines with the industry.

1.6. Research objective

Through this research a two-stage process with C-Suite executives at every South African airline and industry experts from around the world was undertaken, whereby General Morphological Analysis is assessed in terms of its capabilities and appropriateness as a tool to aid executives within an organisation, as well as consultants to an industry in identifying all relevant parameters affecting and their interaction in influencing a future world and thereby deducing a likely future upon which strategy designs and adaptations can be based.

If General Morphological Analysis is demonstrated to be robust through this case study, it is a tool that should be included in each leader and consultant's arsenal who works in the design and evaluation of corporate strategy.

The findings from this study will also enable future research as general morphological analysis is traditionally used as a preceding enabler to future research. The results from this morphological analysis study will provide the input variables for the development of a complex Bayesian network model (Ritchey, 2009).

Chapter 2 – Literature review

2.1. Introduction

To support the motivation and objective of this study an in-depth review of the existing academic literature was initiated. This review of literature evaluates the existing body of knowledge that frames the context and supports the evaluation of general morphological analysis as a strategic planning tool in an ever changing regulatory environment through foresight in identifying parameters that have effect on a particular industries future.

The literature is focused towards understanding the importance of a clear long-term strategy that is continuously adjusted and updated through the discovery of insights about an uncertain tomorrow. Such discovery and understanding come from future studies or scenario planning as it is also known. This review considers the history of such studies, the reasoning for conducting such studies as well as a review of each broad methodology. To this an in-depth review of general morphological analysis, its history, uses, strengths, short comings as well as the unknown capabilities.

Additionally literature that has evaluated the political history of regulation, a move to deregulation and the effect of uncertain and ever changing politics as well the impact of the economy on the regulatory environment. Literature reviewing the risks for organisations who are not able to work within and exploit this environment versus those who benefit in their capability to adapt to the ever changing regulatory framework is discussed to compliment this regulatory review.

A short review of the airline industry, its history, status quo and future provide clarity in justifying the usage of this industry as an ideal proxy industry to evaluate general morphological analysis, specifically because this industry is somewhat locked in a regulatory time warp (Chan, 2000) yet is expected to experience massive regulatory change in the short to medium term (Iatrou & Mason, 2009).

2.2. Long term strategy

Today few organisations can claim that they apply a broad view and a true 10 – 50 year long term view of the business environment when formulating and improving their strategies. The advantages to long term strategy foresight include the improved ability to deal with problems and challenges when they arise, rapid recognition of new opportunities, and the ability to generate realistic goals that serve to motivate and align effort for the organisation (Bezold, 2010).

Organisations and nations need to evolve policy to reflect an emphasis on strategic long term leadership and refrain from the policies of micro management (Richards, 2011) and narrow focus. Instead they must consider a broader view of the environment within which they exist (Bezold, 2010). Practices such as quarterly financial reporting and the burden of producing rapid result leads managers to making short-term decisions that can be immediately measured (Bezold, 2010; Marcus et al., 2011) and should be abolished in favour of a long term view.

Managers must continuously scan the external business environment horizon and be conscious of managerial failures, especially within large organisations where senior members often surround themselves with 'yes men'. Although harmonious to work in an environment where contrarian views are quashed, a real risk exists of falling prey to groupthink. Groupthink is a term for "a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' strivings for unanimity override their motivation to realistically appraise alternative courses of action" (Janis, 1972). Groupthink results where decisions are made in consensus within a group or organisation. The ability for one person to challenge the held view of a cohesive group is limited as a result of groupthink, as is the information upon which decisions are taken limited by a shortened and narrow horizon (Edman, 2014).

With this shift in paradigm to a long term strategy cognisant of the business environment, a great burden is placed on leaders and decision makers to adjust their response to meet ever changing regulations (Marcus et al., 2011). Changing regulations and the massive impact thereof upon strategy design are further discussed later in this chapter. For managers to achieve they need to adopt a multi-faceted approach that is methodical and tailored to their organisation, both its needs and characteristics (Habegger, 2010) to scan and discover insight into parameters shaping an uncertain future.

2.3. Future Studies

In planning for the future, foresight is a crucial function for all organisational leaders, in identifying threats and opportunities (Könnölä, Scapolo, Desruelle, & Mu, 2011). The future is shaped by nature, social and political, scientific advancement and innovations in technology. The purpose of future studies is to explore these dimensions systematically to understand the future thereby improving decisions and in part shaping our future (J. C. Glenn & Gordon, 2003).

Future studies utilise scenarios as the primary technique to guide strategists through discovering what possible future states might look like. The purpose of future studies is not to predict the future, rather it highlights data at a meta level, reorganises the data to provide meaning and insight which influence and guide decision makers when making decisions on an uncertain future (Mietzner & Reger, 2005).

This capacity of an organisation and it leaders ability to change must be built as a priority to deal with such uncertainty. Such capacity leads to flexibility in thought as well as response which provides a definite and measured advantage (Marcus et al., 2011). “As change accelerates and uncertainty increases, using scenarios exploring that uncertainty is a critical part of strategic foresight. Scenarios are not the only tools, but they accomplish a broad range of objectives. It is critical to focus the objectives for the organization, gather the needed resources (both financial and top management time), consider and involve key stakeholders, integrate the effort into ongoing scanning and planning. Develop scenarios that explore expectable, challenging, and visionary futures” (Bezold, 2010, p. 1517).

2.3.1. History

The concept of scenario planning can be traced back to the period just after World War 2. The US military had decided to investigate alternative strategies based on what they expected their enemies' strategies to be. They worked on various alternative strategies to counter any possible strategy that an enemy may institute (Mietzner & Reger, 2005) to attack their troops, equipment, position and allies.

The drive to formalise the practise of scenario planning as a methodical and reliable process of future study was undertaken by the US department of defence in the 1950's (Daum, 2001). One of the top futurists at the time, Herman Kahn who through his part in the US department of defence effort proposed that the methodology could be manipulated and refined as a powerful diagnostic for the corporate world to scan the complex business environment to build meaningful stories which could steer thought to anticipate the challenges and opportunities of an uncertain tomorrow. This he later proved when his work formed the foundation of today's gold started in future study the so called Royal Dutch Shell method.

During the 1960's the major contribution by Herman Kahn was his escalation ladder. He believed there were stages or steps that existed between a country being in a state of 'not at war' and being in a state of war. Each of these escalation steps had a story, a set of events that lead from one stage to the next. Dependent on how the nation reacted a step down or a step up closer to war could ensue. The process of analysing the chain of events that lead from one state to the next and visualising the final state was the first methodology to interpret complex data. The responses thereto could be systematically worked through to build a story that is logical, comprehensive but most importantly plausible on the effect of such decisions and its future impact. By recreating the story multiple times, with varying decisions along the way, strategists were for the first time able to build multiple plausible permutations reliably about the future (Mietzner & Reger, 2005).

2.3.2. Application

Different types of organisations use future studies for varying reasons, businesses rely on the outputs to enhance their awareness of future markets, opportunities and threats. Socio Political leaders rely on the studies to develop the best possible future societies (J. C. Glenn & Gordon, 2003). Future studies are also conducted by governments, policy makers, the scientific community, disaster and crisis management organisations and educational institutions (Bradfield, Wright, Burt, Cairns, & Van Der Heijden, 2005).

Future studies are undertaken through the careful construction of a series of complex and detailed plots which together form likely scenarios that describe possible tomorrows (Mietzner & Reger, 2005). The data that forms the basis of these scenarios can be qualitative or quantitative, based on judgement, baseline, elaborative, or sequenced data (Bishop et al., 2007; J. C. Glenn & Gordon, 2003) dependent on the methodology employed.

2.3.3. Methodologies

The systematic approach embarked upon at the outset of a future study is referred to as methodology or technique (Bishop et al., 2007). The detail and accuracy of future reports is not only highly dependent on the skills of the practitioner, but also on the methodology employed to conduct the study (J. C. Glenn & Gordon, 2003).

There is a multitude of scenario methodologies available, unfortunately the literature often refers to techniques as new where only a slight change is applied to the existing and accepted work. To make matters worse the literature often contradicts itself on the details of each methodology, and is filled with overlapping articles (Bradfield et al., 2005). As a result of such uncertainty and the rising popularity of future studies, a detailed study called “The current state of scenario development: an overview of techniques” was conducted by Bishop, Hines and Colling in 2007 to review all of the future study methodologies, on which this broad assessment leans. Methodologies can be grouped into the following categories:

Judgment

Popular methodologies include Genius, Visualisation, Sociadrama, Coates and Jarratt. Judgement methodologies are by far the most popular methods of future study, supported by the incredible ease in which they can be executed. As the category names implies the future is imagined based on the judgement and opinion of individuals and is mostly unaided by formal process or substantiation. The genius method was developed by the former military contributor Herman Kahn, who is first credited with asking people to "think the unthinkable". These methods are all qualitative and forward looking. The advantages include no requirement on computing capability to process the outcome, they are easy to learn and reveal novel insight. As the method is so unstructured, it can be difficult to deliver meaningful use from such studies, it further suffers as it relies on the knowledge, intent and capabilities of the contributor with no checks or balances to ensure the reliability (Bishop et al., 2007). One of these methods is the Royal Dutch Shell method developed by the RAND Corporation (Millett, 2003).

Royal Dutch Shell Method

It is imperative that the Royal Dutch Shell method is analysed in great detail, as it is considered the gold standard in future research (Millett, 2003) and thus practitioners follow its principles widely ignoring other method (Bishop et al., 2007).

In the late 1960's Royal Dutch Shell began to dabble in scenario planning as an alternate to forecasting which it had used for business environment scanning and planning. They approached the RAND Corporation who had people like Herman Kahn from the USA military well versed in future planning working for them (Millett, 2003). They considered future studies as their current method of forecasting was inevitably wrong and based on the assumption that tomorrow will be much like today (Romani, Cornelius, & Van de Putte, 2005). This as result of that fact that it did not account for future uncertainties, and amounted to being nothing more than a projection based on current realities (Casey, Cawthorne, & Citro, 2014). The initial reports Royal Dutch Shell received were interesting and although the insights were not ground breaking they were deemed useful enough to prompt further study. The third round of reports presented in 1973 to the board of Royal Dutch Shell proved to be hugely accurate, having foreseen the looming oil crisis of the 70's brought on by the control and output restrictions imposed by OPEC (Casey et al., 2014), prompting Royal Dutch Shell to take action before any of it competitors (Bradfield et al., 2005). This Competitive advantage facilitated Royal Dutch Shells emergence from the crisis as a major oil producer, despite entering the crisis as a relatively small player (Millett, 2003).

This application of this method requires practitioners to consider that there are multiple paths to tomorrow, with steps in each that relies on decisions or events to reach the next step much like the escalation ladder which Herman Kahn also developed for the military (Mietzner & Reger, 2005; Romani et al., 2005)

There are cynics of this future study methodology too. Romani, Cornelius, & Van de Putte are former employees at Royal Dutch Shell with 30 years experience. In their (2005) review of the Royal Dutch Shell method they question the impact and success of the methodology, accusing Royal Dutch Shell management of not having a originisational strategy and thus find the methodology is only succesful in the absense of a robust long term strategy.

Baseline

The stand out feature of this category of future studies is that they show only one future scenario, what they call the expected or baseline future. Application is simple, measurement of current phenomenon trends are extrapolated into the future and this extrapolation serves as the expected future. This methodology does not account for system shocks, and therefore derives an expected future free of system shocks which when looking back at history in most instances is proven implausible. The Manoa technique a type of baseline methodology attempts to account for fluctuations through a causal model built between three phenomenon's identified as the primary factors, and the affect that variances in each of these factors has. These methodologies are popular as the audience is easily willing to accept their envisaged future as it is based on already confirmed trends. As mentioned envisaging one future constrains thoughts of possibilities (Bishop et al., 2007).

Elaboration of fixed scenarios

Unlike baseline this third category of methodologies explicitly requires the consideration of multiple scenarios. Initially a range of generic scenarios is selected and participants as part of the process evaluate these predetermined scenarios, looking for the most likely and reasonable scenario for their circumstance. The advantage to this is that participants do not grapple with creatively envisaging an uncertain tomorrow. The downside is that the initial scenarios are generic and lack deep consideration of the pertinent parameters important to the unique circumstances of each particular study. This study is also qualitative and forward looking (Bishop et al., 2007).

Event sequences

The most well-known event sequence is the probability tree, which like a decision tree, systematic decisions are taken on a journey of sorts but unlike the decision tree we consider probability rather than decisions at each branch to reach the end state. This is based on the fact that life is a sequence of events each determined by a parameter occurring ahead of an alternative, and thus the event which occurred is assumed to have had a higher probability when viewed retrospectively. These event sequences are easy to understand as they are portrayed as we experience life. The disadvantage with such studies is that a timeline is difficult to plot to the probability points. These studies are however quantifiable as they are based on a mathematical balance of probabilities (Bishop et al., 2007; Lisewski, 2002).

Modelling

This quantifiable method is primarily used at predicting the expected future through equations of an expectant variable to a quantifiable parameter. This methodology creates numerous scenarios limited only by the number of permutations that each of the variables allow. Through the requirement of computer modelling, these scenarios can be generated rapidly which gives the audience the opportunity to try many combinations for deep understanding of the effect of each variable. The computer systems can also model the probabilities. The problem with this much data is in finding clarity and often results in an information overload, further the high cost to access skilled practitioners and the complicated nature in analysing the scenarios, results in only well-funded studies having a possibility of reaching meaningful scenarios that equate into success at a corporate level (Bishop et al., 2007; Ward & Schriefer, 1998).

Dimensions of uncertainty

We rely on future studies because life is never easily predictable, uncertainty shapes our lives, and the lives of our organisations too. Most methodologies are based on the premise of having all the information, which is simply not plausible. These dimensions of uncertainty methodologies are built on the premise of uncertainty and that humans and organisation have to accept and deal with complex systems in chaos.

The most basic method is the GBN matrix model based on the book The Art of the Long View by Schwartz. A matrix is constructed comprising two uncertainties, in each uncertainty there are two polar opposite states. These two interlinked uncertainties with two states creates a matrix of just four possible cells, within each a story describing the possible future state is told. Each story represents a future possible scenario based on an uncertain future (Bishop et al., 2007).

The next method, general morphological analysis assumes that the future is complex and that there are more than just two uncertainties describing and affecting the future. Like the GBN matrix model it uses a matrix approach on uncertainties, but does not limit the uncertainties to two. Further instead of listing polar opposite states, each state is listed. Each uncertainty and its states are matrixed against all other uncertainties and listed in columns. Improbable scenarios where two uncertainties occurring simultaneously cannot feasibly exist together are removed as a likely scenario. This adds via a consistency matrix of sorts an added layer of safety in evaluating the future scenarios. This method is complex, and to reliably forecast the future, each state must be individually assessed and summarised into a story. Telling a story for each is difficult as just five uncertainties, each with five states of uncertainty, results in a matrix of 3125 (5^5) possible scenarios (Bishop et al., 2007; Coyle, 2003; Duczynski & Williams, 2000; Eriksson & Ritchey, 2002; Ritchey, 2011a, 2011c). This method is further discussed in the next session (2.3.4) as it is the selected method for evaluation in this research.

These forward looking quantitative methods are best used to consider alternative futures as a result of uncertainty. General morphological analysis further allows for the computation of probabilities. Paradoxically GBN's weakness is the consideration of just two uncertainties, whereas the high number of scenarios depicted in general morphological analysis makes the telling of meaningful scenario stories for each difficult. The practitioner must decide on a simple view of four possible states through two uncertainties or grapple with thousands potentially millions of permutations.

2.3.4. General morphological analysis

As the future is dependent on so many uncertainties, a formal structured methodology is required to analyse scenarios based on numerous and potentially unlimited numbers of complex and interlinked uncertainties. Committing to decisions based upon a single opinion or steered by information that is not cognisant of the complex interdependencies between sectors such as the environmental, economic, and technological or socio political spheres cannot be sound (Habegger, 2010), and thus this complex methodology exists.

Paradoxically the addition of data from all these dimension to guide decisions does not facilitate an easier decision making process as is expected. This is because of an information overload, where guiding signals are lost (Habegger, 2010), and this is where general morphological analysis excels through computerised models.

Ritchey (2009) defines general morphological analysis as "a method for rigorously structuring and investigating the total set of relationships in inherently non-quantifiable socio-technical problem complexes (Ritchey, 2009, p. 1)". He identifies the following analysis as being prime candidates for this methodology:

- Developing scenarios and scenario modelling laboratories;
- Developing strategy alternatives;
- Analysing risks;
- Relating means and ends in complex policy spaces;
- Developing models for positional or stakeholder analysis;
- Evaluating organisations structures for different tasks;
- Presenting highly complex relationships in the form of comprehensible, visual models.

Application

When used in strategy formulation two complementary morphological fields must be formulated. The first contains inputs that can be controlled through the actions of management. The second indicates different projections of future operating outcomes to which management has no or only limited influence (Ritchey, 2009, 2011b, 2011c).

Both morphological fields are then linked for cross consistency assessment to identify the optimum selection of a strategy that remains flexible irrespective of the changing operating conditions.

Strengths

When compared to other approaches morphological analysis has numerous advantages over other methodologies. It identifies new relationships which are often overlooked when using another less structured method (Ritchey, 2009).

Secondly, through the process of morphological analysis concepts that are not correctly and thoroughly cross referenced are identified and removed as they have no effect to the paradigm, and other overlooked concepts that are material in cause and effect are highlighted and can be included.

Most importantly the advantage with the greatest impact is the generation of an audit trail, which allows for the reproducibility of results at a later stage.

An added benefit is the ability to build a Bayesian network model. Bayesian network modelling builds a graphical representation of cause and effect relationships between various predefined input variables garnered from this study. Once a Bayesian network model is quantified it can rapidly propagate newly acquired information accurately through a complex network system (Ritchey, 2009). This model allows managers the ability to visually see the effect of the decisions they make to select an optimal future outcome. This knowledge is invaluable to senior managers in the formulation and adjustment of a business strategy.

Weaknesses

There are however weaknesses to the process. This process cannot be undertaken without the commitment of resources both financial and time. It is not an informal, unstructured workshop held during a group session of just a few individuals in an hour or two. The quality in input of the experts is directly correlated with the quality of the output. It is the researchers foremost responsibility to ensure the group of participants who take part are sufficiently knowledgeable, experienced and skilled to provide data input that is of a high standard (Ritchey, 2009).

Opportunity

The Swedish government regularly consults future studies where general morphological analysis has been used to shape its regulations. Examples include its nuclear energy and defence programs (Ritchey, 2011b). Indonesia has also built models on developing its telecommunications in rural areas (Tesavrita & Siswanto, 2006) using general morphological analysis.

If governments utilise general morphological analysis to consider uncertainties to shape regulation, can industry not anticipate regulatory policy and help shape the determinants which affect such policy proactively as part of the motivation identified in chapter 1 and the strategic long term aims discussed earlier in this chapter?

2.4. Regulation

Changes and adaptations to strategy are facilitated through regulatory change. The economist in its 2011 article ‘American idiocracy’ attribute regulatory uncertainty as the main challenge for American organisations in shaping their strategy. Regulations are a set of instruments that nations rely on to impose requirements on both its citizens and organisations. These requirements impose behaviours, norms and obligations on all. They exist in the ideal to protect, serve, and develop as well as fund the operation of government (Kirkpatrick, Parker, & Zhang, 2004; Scott, 2004). Regulations can be examined through either an economic, sociological or political lens. For instance through an economic lens policy makers step in to address market failures such as monopolies to protect the broader public from abuse (Scott, 2004). Conversely through a political lens, the state justifies the prohibition of new entrants to act as competitors, as a state controlled monopoly serves as a means to enact a national development agenda (Kirkpatrick et al., 2004).

“Regulation is the border between the state and the industry” (Lodge, 2008; Veljanovski, 1991, p. 5) in other words it serves as a touch point for the state to compel businesses to comply with societal norms and fund the expenses and agenda of the state. Cognisant of this concept, “regulations shape the corporate environment and have a crucial effect on prices, factor costs, growth in demand, industry competitiveness, R&D progress, and the commercialization of new technologies.” (Marcus et al., 2011, p. 5). Understanding the why and how nations set about establishing and altering regulations, the implications of such regulation and the continued evolution in regulation is critical for this study. Regulations are constantly in flux as policy makers seek to meet their ever changing objectives and to respond to an ever changing environment (Baldwin et al., 2012).

2.4.1. Evolution

There is broad consensus that reform of regulation and in some instances abolishment thereof leads to improved consumer welfare not only in lower prices but also in technological improvements which improves quality, function and availability. Public advocacy in the latter part of the last century lead to governments exploring the validity of pro regulatory economic arguments on the grounds of natural monopolies and externalities (Demsetz, 1968). This review of policy, paved the way for many industries to deregulate, examples include utilities and telecommunications (Boylaud & Nicoletti, 2000).

2.4.2. Future

The criticism levelled first and foremost on regulation and regulatory compliance is the rigidity and high transactional cost which often impacts on an organisations ability to meet its social and environmental goals (Lyon & Maxwell, 2014). An argument is made that if individuals and organisations alike were self-regulatory the need for governments to promulgate new regulations and enforce existing regulations would be negated.

2.5. Regulation, foresight and anticipatory governance.

Governmental use of foresight as a tool in shaping regulation is undervalued. The government of the United States of America since the days of the President Clinton administration acknowledges that although foresight is not perfect in pre-empting future governance it is better than governing blind. Yet despite this acknowledgment the American government cannot effectively leverage its extensive foresight capability due to a departmental silo mentality amongst the various state departments that seldom meet, and cross collaborate (Fuerth, 2009).

Yet with active commitment to the process governments can succeed to set their policy ahead of the rest of the world. This first mover advantage is demonstrated by the United States of America when set in motion new environmental policy at the 1989 fall of the Berlin wall, “The abrupt liquidation of the Cold War removed a central organizing force from world affairs. We had the exhilaration of possible new beginnings, tempered by a sense of vertigo. And so, for much of this time, my work consisted of efforts to deal with these circumstances by means that would be innovative, long-range, complex, and future-oriented. The common denominator among these experiences was foresight: a quality which set Mr Gore apart from his colleagues from an early date, and which ultimately earned him a Nobel Prize for his work on climate change" (Fuerth, 2009, p. 15).

Regulation by its very nature is uncertain, through foresight decision makers must learn to categorize regulatory uncertainty and act accordingly. Where foresight indicates regulation is all but certain leaders should select their strategy based on the most probable scenario. Where there is somewhat risk, leaders must choose robust options that allow for fall back alternatives, and where possible allow time to delay decisions.

Fortunately when policy lacks complete direction, decision makers can use this opportunity to steer and mould the design of regulation (Marcus et al., 2011). As was the case of Anglo American a South African gold mining company, who in 1984 through their scenario planning developed three plausible futures, all of which pointed to a certain end of the Apartheid race based government. Through consultation with government and stakeholders including the then banned African National Congress, these graphic scenarios were used to shape South African policy, end Apartheid and place South Africa on an unimagined trajectory (Schoemaker, 1995). Business today has the opportunity to leverage uncertainty and contribute to policy formulation through lobbying of the state, for a future based on regulations most suited to long term strategy of growth and sustainability.

2.6. Airline industry

Justification for the selection of the airline has already been provided in chapter 1, however as the industry is very different to other industries a short literature review was undertaken to guide and inform the reader.

The industry is very complex, highly regulated and plagued by regulatory uncertainty. Marcus, Aragon-Correa, & Pinkse (2011) maintain the airline industry would be much better off regardless of the regulatory direction chosen, if the airlines ability and capacity to change is strengthened through robust use of foresight.

2.6.1. History

In years past the airline industry was occupied by nations operating state owned carriers to meet a connectivity objective. The flag carriers as they became known were sources of national pride, and displays of power and prestige. The United States of America was the first country to operate large private carriers and to allow business to meet these objectives.

Many nations still consider national airlines to be of national importance to the state, often fulfilling a flag carrying ambassadorial role (Chan, 2000). Chan believes that although this role is somewhat diminished, many nations still associate their flag carrier with pride and prestige.

The airline industry is however changing, governments are being pressured to utilise state resources wisely and allow airlines to run as profitable business. Through complex regulations the airline industry is hugely inefficient, exhibiting at times only small margins and losses in other stage of the business cycle.

2.6.2. Performance of airline industry at present

The airline industry is plagued by inefficiency through excess capacity, low margins, and high failure rates, many of these challenges today are blamed on the September 11, 2001 attacks in the United States. Although the airline industry has undoubtedly changed post the unforeseen terrorist attacks, the industry has never been truly efficient and stable (Abdullah, Munisamy, & Satar, 2013). Prior to these events, rising costs through deregulation were blamed and before that the high cost of oil. The issues of profitability however can all be attributed to inefficient asset and resource utilisation, lead in part by an industry that is yet to emerge from poor practices with roots dating back to the days of nationalisation (Iatrou & Mason, 2009).

Structure

It is a broadly accepted principle that when compared to privately owned business, state owned enterprises suffer inefficiency. This is attributed to operating with no risk of bankruptcy, broad objectives with no residual claimant and increased rents to labour (Backx, Carney, & Gedajlovic, 2002; Blom-Hansen, 2003; Ehrlich, Gallais-Hamonno, Liu, & Lutter, 1994; Ng & Seabright, 2001; Savas & Schubert, 1987; Sjögren & Söderberg, 2011). Further risk emanates at times from a lack of transparency and an absences of complete disclosure both prolific in state owned enterprises (Shapiro & Globerman, 2013).

In enabling a competitive aviation industry as well as a return to efficiency and profitability it is critical to remove the poor and inefficient practices inherited from a time when the industry was run by nations globally. Further nationality clauses from the bilateral air service agreements must also be removed urgently so that the industry can consolidate. These regulations are stifling on industry and not in line with best practices for other markets and industries (Chang et al., 2004).

Large state run airlines do still exist and are typically burdened with slow decision making and overburdened by corporate governance, whereas levels of decision making autonomy are far greater in privately run business. The ability to take decisions rapidly correlate to higher levels of success (Abdullah et al., 2013). Further they are driven by principles not derived from goals of long-term sustainability and national developmental agendas.

An airline should at all times be steered by decisions focused on sound financial judgement and long-term sustainability. The implementation and management of these decisions by an airlines has the greatest effect on overall performance (Barros & Peypoch, 2009; Carney & Dostaler, 2006; Fethi, Jackson, & Weyman-Jones, 2000; Scheraga, 2004). Yet today's industry is still plagued by onerous regulations and management teams who try to circumnavigate this archaic regulatory mind field.

2.6.3. Regulation

Airlines providing air transportation links are classified as key strategic assets to the wellbeing of a state, therefore governments impose strict regulations to ensure the ongoing survivability of its carriers and the private sector (Cosmas, Belobaba, & Swelbar, 2011).

The major constraint facing airline managers is the regulated operating environment in which they operate. As previously indicated in this chapter regulatory challenges and the uncertainty thereof is not unique to the airline industry ("American idiocracy," 2011). The civilian aviation industry was formalised in 1944 at the Chicago convention where the International civil aviation organisation (ICAO) a UN agency was formed (Evans, 2001). The regulations adopted then are still enforce today 70 years later with minimal changes in burden upon the airlines.

Sans regulations airlines would pursue mergers for improved "efficiencies, synergies, cost reductions, scale benefit's and control of operations" (Iatrou & Mason, 2009, p. 2) if it were not for the current regulatory regime.

Despite calls for free trade and the inclusion of industry liberalisation to all sectors during the Uruguay Round agenda of the Global Agreement on Tariff and Trade (GATT) the airline industry was the only one unanimously excluded from this call to liberalise by all 123 nation members (Aharoni & Noy, 2012). It is generally accepted especially by free market proponents that liberalisation would lead to reduction of inefficiency within the airline industry (Abdullah et al., 2013). Research by Good, Röller, & Sickles (1995), Sjögren & Söderberg (2011).

Even within the African context, moves to deregulation have occurred through the so called Yamoussoukro rounds held in the capital of Côte d'Ivoire. Agreement was reached to deregulate the entire African continent however a lack of political will has resulted in the agreed policies not having being adopted.

Regulation takes the form of ownership controls and controls on the routes airlines serve, through an internationally recognised set of rules called air freedom points.

Air Freedoms

At the 1944 Chicago convention the international traffic rights or ‘Freedoms of the Air’ were identified. These freedoms of the air are a set of rules which allow airlines the right to overfly, land, perform maintenance and operate commercial flights from, to, over or between foreign countries (Krasnova & Ibtasar, 2010) and are still in operation today (Appendix 9.6)

Governments still negotiate these bilateral agreements for airlines to operate and trade, the lack and inflexibility of these agreements impose stifling operating conditions for airlines (Chan, 2000).

Ownership

In a bid to protect the airline industry the United States congress enacted legislation during the 1930’s restricting foreign ownership (Cosmas et al., 2011). As an example the USA allows foreigners to own up to 25% voting stock and no more than 49% of equity in an airline. Control through voting powers as well as the CEO must be held by a US citizen (Cosmas et al., 2011).

In ensuring a nation’s best interest, it was decided during the 1940’s, a time when the world was just awakening from the devastation of World War II, with memories of war still fresh to strictly regulate airline ownership globally. These 70 year old laws still exist today with just a few instances of minor adjustment. They exist in a world which is very different to the 1940’s and now virtually completely globalised, yet the airline industry lags far behind other industries as true reform has not yet occurred (Chan, 2000).

It is argued that as a result of these ownership regulations that there are too many carriers globally and great levels of inefficiency exist (Sjögren & Söderberg, 2011).

Alliances

Unlike other industries such as the financial, telecoms, automobile, manufacturing, and consumer goods the airline industry has not adopted a global mergers and acquisitions strategy (Chan, 2000). Although airlines are seen to be globalised through their international operations they are constrained to hubs originating in their country of ownership and license and far from globalised.

To circumnavigate these restrictions airlines have adopted an alliance strategy. Which although not the optimum strategy remain the only viable alternative within the current regulatory regime (Iatrou & Mason, 2009) to seek gains.

Multilateral alliance membership affords airlines the opportunity to exploit scope and density economies beyond national boundaries. The benefits of such allegiances are rooted in the operational network of an airline (Gudmundsson & Lechner, 2006).

These alliance strategies can be complex in nature but when correctly employed offer the easiest mechanism for an airline to reach a global audience of passengers with a global network on a coordinated schedule, and the ability to collect revenue on a point to point basis irrespective of the carrying airline and routing (Chan, 2000).

Nearly all carriers have a code share arrangement with at least one other airline, and most of the legacy carriers have entered into one of the three complex global alliances (Appendix 9.7).

Airlines around the world in pursuit of a global presence and dominance are entering into alliances. Dominant players where allowed, are acquiring minority shareholdings in other airlines to bolster their presence and position. Unfortunately regulations pertaining to foreign ownership still exist, this slows this natural progression towards acquisitions and overall efficiency. It also slows down access to capital flows which many smaller carrier desperately requie and in some cases blocks such attempts (Chan, 2000).

Only Emirates a Gulf based carrier in the United Arab Emirates has been successful in reaching a truly global footprint whilst maintain profitability without entering a large alliance. They do however rely solely on regional feeder code share agreements, and carry other airlines passengers' for long haul sectors on their large wide body fleet of aircraft.

The major concern is that although many advantages to both the airline and the passenger are documented in terms of lower overall fares, simplified ticketing and routing through alliances these stop gap measures are starting to fail as a result of the true benefits originally envisaged not materialising.

Alliance failures

Airline alliances exist today not as a result of being the optimum strategic choice, but more of a second best direction in response to the onerous regulations in play. These alliances do not offer "true efficiencies, synergies, cost reductions, scale benefit's, and better control over operations"(Iatrou & Mason, 2009, p. 2) but do offer improvements in sales through improved reach and schedule (Sjögren & Söderberg, 2011).

Further the beneficial effect was observed predominantly where carriers operated long haul, short haul which accounts for 72% (Gustafson, 2013) of the world's air travel was not an alliance beneficiary (Iatrou & Skourias, 2005). They are not designed to be permanent in nature, although as the connectivity increases so do the exit costs (Iatrou & Mason, 2009), this places extra pressure on future iterations of airline strategy.

Without complete integration airlines alliances are fraught with challenges. A study by the Boston Consulting group found that only one third of intercontinental alliances survive ten years. Krasnova & Ibtasar (2010) identify the following failure factors in airline alliances:

i. **Wrong partner selection**, predicting the alliance dynamics before entering the agreement is difficult to envisage, however airlines must consider attributes such as size and future potential alliances of a planned partner before signing.

ii. **Governance structure**, airline management is often consumed by the process of monitoring and regulating the intricacies of the alliance. More focus should be directed towards pursuing improvements to attain the promised and planned efficiencies.

iii. **Degree of integration and trust,** airlines today maintain a multitude of alliances, this along with the temporary nature of an alliance often leads to issues pertaining to a lack of trust and true integration.

iv. **Organisations commitment,** as airlines continuously re-evaluate their roles and partners, partnerships can move from being stable to instable very quickly, this notion can affect an airlines commitment to an alliance.

v. **Flows information**, although cross member information builds and strengthens alliances, it too can negatively affect the alliance when information from a partner indicates that they are achieving greater results, be it for example revenue or market share.

vi. **Performance evaluation**, when evaluation of a members performance is foregone in favour of the overall alliance performance, the members results could be less than favourable forcing the member to re-evaluate their position.

vii. **Managing Cultural differences**, identified in their study Krasnova & Ibtasar identifies the failure to effectively manage cultural differences, a major contributor to alliance failure.

2.6.4. Deregulation

The airline industry as with all markets benefit from a free market economy void of operating regulations and protectionism through increased efficiency. This view is upheld for the aviation sector as deregulation fosters a relaxation of barriers to entry, which in turn leads to new entrants and increased efficiencies to remain competitive (Abdullah et al., 2013).

There is a move to airline deregulation, and that the attraction of perceived benefits in international ownership through mergers and acquisitions are enough to justify airlines lobbying for change (Merkert & Morrell, 2012).

With a move to deregulation of the aviation sector it is likely that competition will increase (Cosmas et al., 2011). Further Sjögren and Söderberg,(2011) in their study prove that there will be significant economic gains from deregulation in the aviation industry. Their empirical study confirms the findings of previous studies by Barla and Perelman (1989), Distexhe and Perelman (1994), Coelli, Perelman, and Romano (1999) and Inglada, Rey, Rodriguez-Alvarez and Coto-Millan (2006) that a strong economic case exists for deregulation.

There are other knock on effects to deregulation which will improve customer welfare. As levels of competition increase post deregulation there is a positive correlation to the quality of service rendered (Cosmas et al., 2011).

Despite the positive effects of deregulation to the airline industry all 123 members of the Uruguay round of the Global Agreement on Tariffs and Trade (GATT) which lead to the formation of the World Trade Organisation voted to exclude the aviation industry (Aharoni & Noy, 2012).

Opponents to deregulation argue that any moves towards deregulation in the sector will result in job losses, a reduction in safety and negatively contributes to a severe risk to national security. These regulations are a relic of World War II when nations around the world used civilian airline fleets as troop transport. However the argument holds true today for one country, as the USA relied on civilian fleet during the Gulf war to supplement the US armed forces capacity (Grassi, 2006).

Further the opponents to deregulation believe that multiple competitive airlines can compete on price in every market until such point that no market is profitable, and argue that profit only exists where incumbents maintain firm control of home based hubs so that even the strongest competitors are discouraged from entering the market. (Cosmas et al., 2011). It is true that remuneration between regions in the airline industry does vary and that many of the skills are easily imported.

Certain countries such as the USA have programs in place such as the Civil Reserve Air Fleet (CRAF), allowing the department of defence to use civilian airliners in times of national emergency to supplement the military's capabilities. It is feared that membership to such programs by US based airlines would be negatively affected if the airlines come under foreign ownership (Cosmas et al., 2011). This fear however seems misplaced due to the fact that in return for an airlines membership in CRAF the federal government awards lucrative transportation contracts to the airlines.

Ultimately the status quo as it stands has regulations described as "arcane webs of international agreements by governments around the world, led by the United States" (Aharoni & Noy, 2012, p. 53). These regulations are prohibiting airlines from organising into efficient organisation structures so prevalent in other mature industries.

Open Skies

The airline industry was frozen in "a regulatory time bubble for about four decades" (Chan, 2000, p. 490) when in 1978 limited deregulation occurred in the United States. This led other nations and regions to follow, but none to date have truly liberalised.

Numerous studies have been undertaken thus far that investigate airline strategy in terms of the very limited deregulation that has taken place. These formed the basis of this study, which investigated the likely strategic trajectories for airlines in a world post ownership regulation reforms, route agreement reforms as well as ultimately complete liberalisation.

Antitrust immunity

In a study of the internal US and EU airline markets where deregulation has occurred showed no noticeable reduction in costs or efficiency gains through increased competition. This has been attributed to a private sector that has been slow to respond to the changed regulatory landscape but this is expected to change in the future. With increased levels of privatisation and therefore increased competition, linked to tightened budgetary constraints on inefficient flag carrier state owned airlines, competition is expected to result in an overall 15 – 20% gains to overall welfare (Ng & Seabright, 2001).

2.6.5. Future

Globalisation

Through consolidation the airline industry should reorganise into a global oligopoly in three broad categories. Firstly a few competitors each capable of global reach serving and interconnecting the entire world, this would allow for economies of density and the capability to spread risk across world markets. Secondly a number of low cost servicing only high density routes, and lastly regional carriers who specialise in local markets on a so called final mile

2.7. Conclusion

This review has demonstrated that long term strategy is critical to the success of a business, but that uncertainty is a constant that organisational leaders must confront in their long term planning. A leading contributor identified by the economist as the major cause of uncertainty to business is the regulatory environment ("American idiocracy," 2011). Regulations are a reality throughout the world, and despite the principled spirit of the law makers, the regulatory environment, through its uncertainty is a challenge to decision makers in all organisations. As the environment, economic markets, technology, political will and political motivations evolve, so too must regulation. This constant change and compliance requirement, forces leaders who do consider long term strategy to continuously scan and anticipate the regulatory horizon, in preparation of a swift response. Such preparation and readiness provides massive competitive advantage to organisations.

To adequately prepare decision makers require a vision of the future. Such vision is without use if it is based purely in speculation and imagination, or an extrapolation of current data in the form of a forecast. Given this, an organisation can conduct a future study. Such studies are proven to be valuable, and sources of competitive advantage as was the cases of the oil producer Royal Dutch Shell, and the mining house Anglo American.

Numerous methodologies for a systematic future study exist. These methodologies each have their own strengths and weaknesses. However one method pioneered and widely accepted as the gold standard (Millett, 2003) is taught to, and used by practitioners in most cases in a one size fits all approach. The ambiguity, and contradiction of the literature in determining whether a purpose built methodology for business exists, specifically in regulatory uncertainty scanning has lead this research to evaluate general morphological analysis as the literature review shows this methodology is ideally suited to aid governments in regulatory design but untested by business to anticipate regulatory change.

Through the questions proposed in chapter three the author seeks to evaluate general morphological method for its robustness in detecting the dimensions in an industry that create regulatory uncertainty and to evaluate the opinion of industry experts in the usefulness of such information to shape long term strategy.

These questions are explored using the airline industry as a proxy. The argument to use the airline industry is made through the available literature. Through which the airline industry is shown to be a mature complex industry but uniquely regulated due its perceived strategic importance as a key national asset. These archaic regulations are shown to be onerous of airlines, and confirmed by the interviews captured for this study. The airline is also a low margin business with attempts by airline managers to circumnavigate the regulations through operating alliances largely failing. Thus to ensure long term sustainability especially in lieu of emerging Gulf carrier dominance regulatory change must be considered urgently.

Chapter 3 – Research questions

Mietzner & Reger (2005) identify the need for a process of evaluation for future study methodologies, as well as the evaluation of its effectiveness and reliability. General morphological analysis was identified as a methodology which has already been tested for appropriateness in regulatory design as well as for military application by governments (Ritchey, 2011b, 2011c; Tesavrita & Siswanto, 2006). To date it is has not been tested by organisations as a regulatory anticipatory tool for strategy design in the private sector.

In order to assess the robustness and suitability of general morphological analysis as a tool to aid in the design, assessment, adjustment and implementation of strategy in the face of regulatory uncertainty, four research questions were asked. If through these questions general morphological analysis was found to be useful to uncover the variables and parameters that affect the future state of an industry, then this insight would be a useful decision making aid to leaders when formulating their future strategy especially with regards to regulatory uncertainty.

This awareness would demonstrate that future studies and general morphological analysis in particular is useful to industry, and should not be ignored as is the predominant status quo within corporations globally (Burt & Van der Heijden, 2003; Varum & Melo, 2010).

The output report if perceived to be plausible by decision makers, leaders and experts would accelerate adoption of general morphological analysis by organisations.

3.1. Research question 1

> Can general morphological analysis be used to analyse an industry to reveal detailed and thorough insight into the most pertinent variables and parameters that could affect the future trajectory of an industry? Specifically, what is the completeness of the variables and parameters uncovered, and level of granularity identified?

3.2. Research question 2

Are the experts of the opinion that the insights uncovered are of use in formulation of a likely future scenario with regards to future regulatory uncertainty?

3.3. Research question 3

Mietzner & Reger (2005) postulate the acceptance and usage of future studios through scenarios but question the applicability to improving a firms performance.

Are insights derived from a general morphological analysis study valuable to an organisation in the design of future and the adaption of current strategy plans?

3.4. Research question 4

Does an interaction with the process of general morphological analysis, and access to the results from such a general morphological analysis study, increase the likelihood of leaders and experts in the field to consider general morphological analysis as a tool when designing, reviewing and implementing strategy?

Chapter 4 – Research Methodology

4.1. Introduction

This chapter is premised on the basis of ascertaining the most appropriate research methodology to comprehensively answer the questions posed in chapter 3, surrounding the evaluation of a reliable, robust future study methodology in the complex and uncertain regulatory environment first identified in chapter 1.

General morphological studies thus far have centred on academic research, none could be found that evaluated the method in a real world industry where the output is measured for its usefulness. This vacuum is the literature lead the author to a natural field experiment methodology.

4.2. Research design

Dennis and Garfield (2003, p. 297) postulate "quantitative research is theory in search of data while qualitative research is data in search of theory." General morphological analysis in itself is a qualitative method and a quantitative design could thus not be specified.

A natural field experiment design was selected to derive in-depth understanding in a real world setting (Bromley, 1986). This real world setting provided the ideal circumstances to engage with experts in the industry that served as proxy for the evaluation of general morphological analysis.

During a natural field experiment the participants are aware of the fact that they are participants in the experiment, but are not conscious of the true motivation for the experiment (Harrison & List, 2004). This mendacity is justified in the pursuit of responses that have not been tailored by what the participants believe will best suit the research. Ethical clearance in this regard was sought and approved.

Descriptive statistics were employed in the final stage once the true motivation for the research was revealed to the participant to unearth meaning in their evaluation of the report generated through the general morphological analysis process.

4.3. Research methodology

To access the robustness and suitability of general morphological analysis a two staged approach to the research was undertaken. During the first stage the author acting as a consultant met with, and interviewed c-suite executives at airlines, representative organisations, industry experts and senior consultants to the industry. The interviews were conducted under the premise of an industry assessment to test the airline industries response to the changing regulatory environment.

This data was then coded and analysed for trends (annexure 9.8), from which a future study utilising the principles of general morphological analysis was developed and presented back to the subjects in the form of an industry report (annexure 1).

After considering the report the subjects completed a survey scoring the expected accuracy, insight displayed, usefulness and persuasion to using general morphological analysis within their organisation in the future as a tool to decipher uncertainty in the regulatory sphere. This data was then interpreted to evaluate the robustness and appropriateness of general morphological analysis as a tool to aid executives within an organisation, as well as consultants to an industry in identifying all relevant parameters affecting, and their interaction in influencing a future world and thereby deducing a likely future upon which strategy designs and adaptations can be based.

4.4. Population

The population is defined as all decision makers and their consultative council carry working within the airline industry. Due to the nature of the proxy industry used, no geographical boundaries were imposed.

4.5. Sampling

A judgment selection of certain industry experts has lead the author to a nonprobability snowball sampling technique with subsequent selection based on referrals. In utilising this technique research participants were asked to assist the author in identifying other potential subjects. Saunders and Lewis (2012) recommend this technique to reach easily identifiable but difficult to access executives within an organisation. Participants had the right to refuse the request, but none exercised the right and all but one obliged.

Guest, Bunce, & Johnson (2006) found that a sample size of six to twelve was more than adequate when undertaking qualitative research. Morphological analysis too requires a small sample of participants with an ideal size of six to eight persons (Ritchey, 2009). C-Suite executives were interviewed including the chief executive officers at three airlines, the chief strategic officer at a global legacy airline, two consultants to the industry and the president at an airline representative body. Through their combined global experience, rich globally applicable datum was collected.

4.6. Unit of analysis

The unit of analysis are the decision making executives within an organisation.

4.7. Interview schedule

The author identified and compiled open-ended questions into a questionnaire schedule used during his semi-structured interviews, attached hereto as annexure 3. An open-ended questioning technique was adopted to ensure that all themes proposed for the proxy report could be interrogated during in each interview, but allowed the interview to remain flexible enough to allow for changes mid-interview either through responses requiring further in depth questioning, or to ignore a set of questions as a result of non-applicability.

4.8. Pre-test

A pre-test of the interview was undertaken with the president of an international airline representative body.

4.9. Data collection

The questions identified were put to the executives during the semi-structured interviews are attached hereto as annexure 9.3. The purpose thereof was to ensure that all themes proposed as research questions were interrogated during each interview, but remain flexible enough to allow for changes mid interview either through responses requiring further in depth questioning, or to ignore a set of questions as a result of non-applicability.

All interviews were recorded by digital recorder to digital media, transcribed and stored digitally on the researcher's personal computer, a server in Johannesburg South Africa, a server in the United States, as well as in Auckland, New Zealand for redundancy.

An online survey, hosted at www.surveymonkey.com was made available to participants during the second phase of the research process.

4.10. Data Analysis

Atlas ti software which is "among the best available and potentially most useful qualitative data analysis (QDA) tools" (Lewis, 2004, p. 439) was used during the analysis phase. This software coded concepts from all the interview transcripts to assist the researcher to highlight critical concepts, beliefs and experiences, it also acts as a safety mechanism to ensure that critical concepts recorded were not discounted either in error or as a result of researcher bias.

This textual analysis methodically analyzed the responses garnered during the interview process, into concepts rich in data that were interpreted into meaningful understanding. These were utilized for the

4.11. Limitations

4.11.1. Groupthink

Groupthink is a term for "a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' strivings for unanimity override their motivation to realistically appraise alternative courses of action" (Janis, 1972). Groupthink results where decisions are made in consensus within a group or organisation. The ability for one person to challenge the held view of a cohesive group is limited as a result of groupthink, as is the information upon which decisions are taken limited by a shortened and narrow horizon (Edman, 2014).

4.11.2. Researcher Bias

Poggenpoel & Myburgh (2003) argue that the researcher acting as research instrument poses the greatest threat to the trustworthiness of qualitative research. They add it is critical for the researcher to undertake the necessary preparation before the interview and remain humble during interview so that truly representative evaluation can be done.

4.11.3. Homogeneous sample

Respondents “selected for a snowball sample are most likely to identify others who are similar to themselves, resulting in a homogeneous sample” (Saunders & Lewis, 2011, p. 140). The risk is that the sample did contain insufficient variance.

4.11.4. Non-probability judgmental sample

Due to a non-probability sample being employed, it cannot be inferred that this sample will be representative of the universe. Six of the eight participants were located in Johannesburg and thus it was feared that data biased to the South African context could be collect. However all but one of the respondents had vast international experience at a plethora of carriers abroad. Further tw

4.11.5. Longitudinal effects

The time to investigate, interview and analyse the responses is limited by the deadline imposed on this research study by the university.

4.11.6. Time with subject

Due to the profile of the respondents, time allowed with each respondent was limited, this limited the number of questions that could be asked and potentially limited this research.

Further limitations in time made available for interviews, the research process could be constrained from establishing meaningful rapport with the subject, preventing the subject from sharing the true essence of the responses tendered.

4.11.7. Ethical Considerations

Managers could've been hesitant to reveal company sensitive data of a strategic nature as it could either be a source of competitive advantage or an identifier of the participants' true identity. The researcher had an obligation to ensure that information collected is only the personal opinion of the respondent and not of the organisation they represent.

Further data was recorded with fictitious names linked to a fictitious company name. The respondents name and organisation was removed from the data.

The author acknowledges that this research had potential for harm to the participants, however all reasonable attempts to mitigate such risks will be taken, in accordance with the ethical clearance granted (Hofstee, 2006).

Chapter 5 - Results

5.1. Introduction

The research design called for a two stage data collection process, the results from each stage have been separated. During the first phase data was collected in interviews held with each subject, and the data from each is thus industry specific. This data was coded, analysed and prepared into an industry outlook report (annexure 9.1) and presented to each participant for further consideration. This stage of the research was critical, and careful analysis was afforded to these interviews, as the quality of the data captured at this point could significantly influence the evaluation of the methodology. Although industry specific, this data if incorrectly identified could skew the results and jeopardise the findings in evaluating general morphological analysis as a strategic design tool. The author transcribed each interview personally comparing the voice recordings to the notes taken during the interview surrounding the participants' demeanour.

For the second part of the data collection process the subjects completed an online survey, which analysed the report prepared on their industry using general morphological analysis. This data was then used to evaluate the robustness and appropriateness of general morphological analysis as a tool to aid executives within an organisation, as well as consultants to an industry in shaping the design and constant adaptation to an organisations long-term strategy.

5.2. Results: industry data

The interview process uncovered rich data due to the participation of key industry experts that included airline chief executives, chief strategy officers, a president of an airlines association and senior consultants, that together have experience in airlines large and small on a global basis. As the impact of regulatory change is not fully understood within the industry, participants had a mostly biased opinion, guided by the expected impact of such changes to their own business or respective clientele. At this juncture, the participants were perceived to have a short-term company specific vision and the implications on the industry in the long term is not yet considered or understood in full.

Nearly all of the participants believe that there will be a continued move towards liberalisation in the future, but that complete liberalisation will not occur “in my lifetime” (Annexure 4 – Transcript 3 and Transcript 4). Regulation is so entrenched in the airline industry, and is the accepted way of doing business. The average airline experience across all subjects interviewed was 31,34 years. This confirmed the suitability of the identified persons as participants to this study, but also blinkered their vision to considering alternate possibilities.

Each participant was given the opportunity to propose changes to the current regulatory regime. The thought of such a shift was initially so foreign that most dismissed the idea immediately, replying to the question “would you adjust” by saying “No, not at the moment” (Annexure 4 – Transcript 6), “I don't think the real issue is regulations quite honestly” (Annexure 4 – Transcript 5), “I'm struggling with that one because the regulations are a given constraint throughout my career and they don't particularly make my job more difficult in some sense they support my job I suppose” (Annexure 4 – Transcript 7).

However after the initial response, and with some passing of time, all participants returned to the question and proposed easing of the regulations that were focused on accessing new markets, and new investment to enhance their business. Most liberal was the CEO of a Regional South African airline who said “I don't have a problem with hundred percent foreign ownership either, I think the transportation industry throughout the world is globalised, it's really globalised and we as South Africans and Africans I think need to get with the program and you can't be resistant, it’s coming, so if we keep on with these prohibitive regulations all we doing is we resisting it, but it's coming.” (Annexure 4 – Transcript 1). Other comments included “Depoliticise the industry that's the real (solution)”, “solution for me would be proper level playing field competition law for Africa” (Annexure 4 – Transcript 5), and “I actually don't have a problem with the 51% local 49% foreign so I could actually go 51% 49%” (Annexure 4 – Transcript 6).

Paradoxically they simultaneously wanted to reaffirm and in some instances tighten regulations that block growth of the incumbent competitors, as well as the entrance of any new competition, especially foreign based "I still think I want the majority owned here" (Annexure 4 – Transcript 6). Another added "there could be a danger that with 100 percent foreign ownership, then actually you could move right to the extreme, there's extremes to this, with 100% foreign ownership you could potentially see an Emirates of the world takeover say an Italian airline and actually decisions then potentially get made on the basis of profit, and are made from the point of view of say the owner with 100% stake and not in the interest maybe of the wider economic benefits of that state or country" (Annexure 4 – Transcript 2).

Two distinct areas in the current regulatory regime were identified as major influencers and interrogated for deeper understanding. The first being the bilateral agreements also known as the freedoms of the air, and secondly the cross border ownership rule. Each is discussed in detail below.

5.2.1. Bilateral agreements

The current dispensation dictates controlled access to specific markets as well as capacity made available on each. This access is negotiated on behalf of each airline by their respective government. It is an unusual situation for a private industry to be reliant upon the state to enter negotiations for and on behalf of the company to access new markets and or capacity.

The process of negotiating a bilateral agreement is inefficient, slow, and corrupt, which severely impacts the airlines capability to react to market changes promptly, which favours incumbents who already have routes allocated. "We need more capacity and to get more capacity allocated to us is a whole process, entailing not just our department of transport, but their reciprocal department of transport in Botswana and very often the Botswana department of transport may turn around and say no we don't have an appetite for it because until there is an equalisation of the opportunity between our national carrier and South Africa's designated carrier" (Annexure 4 – Transcript 1).

An indicator of a well-run airline is agility, with respondents claiming “You have to be dynamic you have to observe the market and you have got to move quickly, I have always maintained you get the quick, and you get the dead so choose one of those, if you not quick you going to die” (Annexure 4 – Transcript 1). This allocation of the bilateral is critical to commence operation of a route and thus any airline that is impeded by the bureaucracy will be slow to react.

This process is further complicated by the fact that in many markets the state themselves own and operate an airline, and favour this, their own carrier during negotiations with other states. “In most African countries the airline runs the Department of Transport in this policy, so if you take a country like Angola even if you get the rights to fly into Angola you have to negotiate what they call a commercial agreement with TAAG before you allowed to operate, now that is probably one of the worst examples where they actually openly say to you, listen you have got to negotiate with our state carrier as to how whether you can come up with a suitable arrangement that they will allow you to operate. In many other countries you find that the national carrier basically decides, you know what is going to happen with capacity” (Annexure 4 – Transcript 5).

As this process of negotiation is an act of diplomacy by two nations, the process can be cordial with a limited focus on sound business judgements. Other than the wellbeing of the airline industry, judgement can be clouded by political motivations, including foreign investment by a wealthy country wanting air access or political as in South Africa accessing Beijing for political rather than commercial reason.

Bilaterals are very restrictive and generally issued as a certain number of frequencies by day or week, and in some cases additionally limited to a specified number of seats. “And the trouble is, we do frequency based bilaterals and not seat based, we do seat based when we have to, I think Mozambique is seat based, but a frequency based bilateral into a state that has an airline, that only has a wide body fleet type, and one includes the A380, if somebody cannot understand the consequence of doing that, the potential consequence of doing that” (Annexure 4 – Transcript 4).

In the spirit of diplomacy, the bilateral is usually reciprocal, in other words for each frequency our country receives, the other country receives an equal number. This results in anti-competitive behaviour. As capacity on the route is constrained the airline that offers on time and reliable performance will attract more customers, and this develops and grows the route. In turn they will achieve high occupancy. Unfortunately they cannot add capacity to meet this demand that they have built, until such time as the other countries carrier also requires extra capacity. This nuance results in a degradation of consumer welfare as passengers are coerced into flying on a non-performing carrier. “They don’t really have an appetite to open up any more capacity on the route. It's a forced equalisation, it's not market natural equalisation, there is no market natural equalisation, the market will basically support the carrier that operates most effectively and delivers the best service product to the consumer” (Annexure 4 – Transcript 1).

Liberalising bilaterals

Complete liberalisation of the bilateral framework presents a number of challenges. Firstly the bilaterals offer a level of protectionism to weak and inefficient carriers, in many parts of the developing world this usually exists in the form of a state run national carrier, this alone is a major hurdle in nations taking an alternate view to the bilateral regime, “some of the states have basically said our priority is particularly our national airline, so we have a situation in certain areas where states have said we don't want to allow applications to certain of those freedoms of the air” (Annexure 4 – Transcript 6).

Airlines today cannot operate on any route, and thus most operate those that they can, if these restrictions were to terminate, airlines would be allowed to operate any routes that they desire. Airlines would thus chase profitable routes and abandon weak routes, which would result in reduced connectivity, and a reduction in competition, which erodes consumer welfare, one airline executive admitted this: “the driver for these airlines for any airline is flying routes that consumers want to fly that they know are profitable and that they can sustain and make work” (Annexure 4 – Transcript 2).

In small and underdeveloped markets, the removal of this effective barrier to entry would attract newcomers as well as strong outsiders to enter the market. This would result in a race to the bottom in terms of revenue through reduced fares “as I say where there is too much competition and in having too much competition prices hit rock bottom and there is this race to the bottom” (Annexure 4 – Transcript 2). Respondents believe that the incumbents, especially the small and local carriers, would be the casualties, after the removal of these incumbents through unsustainable behaviour of larger outsiders, consumer welfare would suffer through higher prices as a result of no competition. Without choice passengers can expect degradation in service and performance.

There have already been pockets of liberalisation to the bilaterals, the United States of America liberalised the domestic market in 1978 (Chan, 2000), Europe followed suit and so did South Africa. These markets have seen a barrage of new entrants, all adopting a differentiation through cost model, which has resulted in a race to the bottom and an ensuing rationalisation of carriers, market upheaval and a devaluation of the whole industry in the minds of the flying consumer. The South African experience has exhibited similar trait’s but in addition the market has been influenced by the presence of a national carrier, which at times has been charged by some respondents to have acted in an anticompetitive and unsustainable manner ” (Annexure 4 – Transcript 6).

As the bilateral liberalisation occurred in isolation, without liberalisation of the ownership regulations, the move attracted no foreign investment and thus only opened the market to locals flying local destinations.

Although European liberalisation was cross border it was constrained within the European trade zone and their experience has been similar to that of the USA and South Africa. They however had added a level of protection through their strong competition laws; this prevented the race to the bottom (Annexure 4 – Transcript 2). Further they have allowed cross border ownership, but regionally constrained to within the trade zone.

Africa has attempted to implement a cross border policy to liberalise routes within the continent, a gathering of all African states resolved to completely liberalise the African continent air routes at Yamoussoukro the capital of the Côte d'Ivoire. This along with future meetings has become known as Yamoussoukro agreement where in principle Africa has agreed to an open skies liberalised air space, but the political will has been absent, in the face of fears of loss in sovereignty, political power, connectivity and commerce (Annexure 4 – Transcript 4).

Both the United States and Europe as a single trade zone entered into an agreement to liberalise routes between the Unites states and the European union, however again this opening up of routes has been restricted to airlines only from either region, with additional provisos and concessions allowed (Annexure 4 – Transcript 4).

The main problem however with liberalisation of the bilaterals is that countries can still limit growth and new entrants through the control of slots at popular airports. A slot is a time based position to take off or land at a nominated airport, this allows access to a gate and in theory is limited by the number of movement that an airport and its surrounding air space can handle safely during the day. (Annexure 4 – Transcript 7)

When the EU and the USA opened up the Trans-Atlantic routes, it did not become a free for all, as popular cities like London and New York could not allow additional aircraft movements. Incumbent carriers especially British Airways held on to these slots and effectively blocked competitor access to their markets (Annexure 4 – Transcript 2). Popular slots like those at Heathrow, were reason enough for British Airways to acquire BMI.

As the environmental agenda builds prominence airports throughout Europe are introducing blackout zones, where no planes may take off or land unless in an emergency to prevent sleep time noise pollution for areas surrounding the airport and below the approach and departure routes (Bryan & Maushagen, 2012). This shrinkage of the operational capacity at busy airports will further constrain available slots. This will in effect act as a backup regulation to control and limit access should the bilateral regulations be scrapped.

As the liberalisation of the bilaterals in isolation has not had the desired effect of strengthening the industry, the respondents deemed the liberalisation of these regulations to be secondary in effect. Paradoxically these regulations are expected to continue to relax and liberalise in the future, with the ASEAN states soon to adopt an open skies policy in Asia (Annexure 4 – Transcript 4). Further deregulatory tweaks to the bilateral regimes are not forecast to strengthen the industry. Further as proved in recent events, the South African government have reneged on a bilateral with the United Arab Emirates and this trend is expected to become of greater prominence in future (Annexure 9.5).

5.2.2. Ownership Dimension

The ownership dimension revealed much deeper insight by the experts. Interestingly within this dimension there were factors in which there was unanimous agreement, whereas others strongly divided the participants.

With the exception of Chile all countries limit foreign ownership of the airlines operating within their country (Gillen, 2008). For instance in Australia they allow 100% foreign ownership of domestic carriers, but limit foreign ownership in international carriers to 49% but with additional restrictions on the national carrier Qantas. In the United States foreign ownership is restricted to 25% with the possibility of 49% on a case-by-case basis. The European Union allows up to 49%. South Africa allows for 25% foreign ownership (Annexure 4 – Transcript 1,3,4,5, 6 & 7).

This regulation limit's foreign direct investment, consolidation and effectively constrains the entire industry from globalising as countries are limited to home based hubs through the enforcement of bilaterals (Annexure 4 – Transcript 1).

The arguments supporting these regulations include military capacity, airlift and the implementation of a nation's agenda (Annexure 4 – Transcript 7). Both ownership and bilateral regulations stem from the 1944 Chicago convention and the creation of the International Civil Aviation Organisation (ICAO). The timing of this convention post World War 2 is pertinent, these agreements and regulations are still in force today 70 years later (Chan, 2000). There was agreement that the regulations were essential at the time and enabled passenger safety (Annexure 4 – Transcript 3 & 6), the airline industry is the safest mode of transport today, but the laws are antiquated and require a shift to keep up with a markedly changed world today.

The need for military lift through the commandeering of airliners is thought to be unrealistic and it was postulated by some that a free market would provide more than sufficient capacity to any military at a price. The need to control ownership of airlines in case of war is said to be an overreaction for something that is unlikely to occur, with the United States of America the only nation cited by the experts as actively moving large volumes of troops on a global scale. The cost of this unlikely eventuality is burden on the airlines through the inability to grow through investment, consolidate and seek efficiencies; this in turn negatively impacts passenger welfare (Annexure 4 – Transcript 5).

The other reason cited is airlift, airlift is the capacity to move people in and out of your country and connect to the rest of the world. Airlift does not have to be locally owned or locally based, for instance Cathay Pacific provides airlift to South Africa through its daily Hong Kong to Johannesburg (Annexure 4 – Transcript 1 & 5). The belief is that if you don't have influence on local carriers you are at the mercy of foreign operators to provide that airlift. The president of the South African Airlines Association believes that in South Africa there is more than sufficient capacity (Annexure 4 – Transcript 6).

Other respondents were of the opinion that if a major carrier such as Blue Diamond air were to fold, the vacuum created by their demise could be filled in short time, regulation permitting by foreign players, and that any fallout would be short lived (Annexure 4 – Transcript 1,5 & 6).

The last argument is that of national agenda, however this particular point cannot be fully considered without discussing state run national carriers. In many parts of the world nations own and operate airlines, this is especially prevalent in developing parts of the world. The issue of whether a state actually requires its own carrier was the single point that divided the experts the most. All had strong views on the issue of state ownership of airlines, some for and some against.

Those arguing against state owned carriers levelled claims of inefficiency, poor business acumen, zero accountability and anticompetitive behaviour. It is argued that the state can have an objective, but could achieve same through a process of ring fencing these objectives and placing each to tender (Annexure 4 – Transcript 5). An example given is the Johannesburg to Beijing route, Blue Diamond air is rumoured to be losing a fortune on this route with below par fares and poor occupancies, whilst the government of South Africa courts the Chinese government. Through their argument they felt that Blue Diamond air if it were private or a Chinese carrier through a process of a Dutch auction could bid to supply the airlift at a minimum of x frequencies per week for a predetermined cost per year. That way government could still achieve its objectives sans the burden of a national carrier.

They add that there is a move from state owned and run enterprises in other industries around the world such as the production and provision of energy, and that a state owned airline can only truly achieve benefit to the nation as a whole when all the departments and not only the ministry of transport are aligned (Annexure 4 – Transcript 4).

Their major concern however is access to what is effectively an open cheque book, this leads to a loss of accountability and a maverick style of management where unlike private industry who faces the possibility of bankruptcy through poorly informed decisions, state owned corporations operate free of such risk which leads to poor performance (Annexure 4 – Transcript 1). Further the state has sufficient resource to lead loss-making ventures with the aim of stifling competition (Annexure 4 – Transcript 1,3, & 5).

Those who could justify the existence of state owned airlines cite Singapore Air, and the Middle Eastern carriers such as Etihad, Emirates and Qatar of what can be achieved by a national airline. They argue that these countries would not have been on the global stage had the airline not made this possible (Annexure 4 – Transcript 1,2,3,5 & 7). Even today 9% of the passengers carried by Emirates are only in transit at Dubai. This transit traffic sustains a major airline with global reach whose benefits extend to all in Dubai, and as a result of relatively low operating costs the carrier can operate without any cost to the taxpayer (Annexure 4 – Transcript 4 & 5).

Countries wishing to open up trade with other countries can also use their state airline to fly routes with little demand, whilst demand is built as trade between the two countries mature.

Lastly in a case of South Africa, the government through its carrier South African air has made people development top of its agenda. Pilots, Cabin crew, ground staff and management of colour have all been lured to this industry, which was previously the preserve of white South Africans (supported by subject at the national carrier and Annexure 4 – Transcript 6).

Those in favour of national carriers continue to advocate the benefit the carriers have on national pride and their ambassadorial importance. However those opposed advocate for flag carriers such as British Airways who carry the British brand but are no burden to their state (Annexure 4 – Transcript 3, 4 & 5).

Through the operation of a national carrier, the state employ the ownership control regulations as a mechanism of protectionism to safeguard its investment, agenda and pride.

All agreed that the airline industry globally has an oversupply of capacity and believed that there has to be, and is a move towards consolidation. Despite the regulations there are already examples of this happening, most notably in Europe where these transactions within the European Union are permitted. KLM and Air France have merged under one umbrella, as well as British Airways and Spanish Iberia under the IAG umbrella (Annexure 4 – Transcript 2). These are reported to have been very successful financially through the achievement and leveraging of synergies that existed between the two entities. They were also able to access markets in which they were not previously strong, for instance most BA flights to South America now include a sector to Madrid before boarding an Iberia plane to Latin America.

Outside of Europe, Latam in South America is doing very well formed through the consolidation of few large carriers in South America, after a period of region wide state airline failures. Airlift has not been impacted in this region as had been previously expected (Annexure 4 – Transcript 4).

Lufthansa has instead of consolidating with acquired airlines in Europe including Austrian, Swiss, German Wings, Brussels Airlines, Air Dolomiti and Lauda, with stakes in other carriers ranging from 13% - 99% in other parts of Europe the USA and Africa (Annexure 4 – Transcript 1,4 & 5).

Most interesting has been Etihad's acquisition strategy where they have taken between 3 and 49% stake in airlines around the world including, Alitalia Italy (49%), Air Serbia (49%), Air Seychelles (40%), Darwin Switzerland now rebranded Etihad regional (33,3%), Virgin Australia (10%) and Aer Lingus (2,987%). What has made their acquisition policy interesting is that in certain couriers they are placing the person at the helm in the case of Air Serbia and Air Seychelles. One respondent claimed "The guy in Darwin Airlines, I spoke to him at a conference in Dublin, he says they have a management conference call every Monday morning and they basically get told this is what you're going to be doing in the next week by Qatar (SIC), he has no say in the business anymore, it's a Qatar (SIC) business now, you can keep your branding but we in charge now. (Annexure 4 – Transcript 5 & 7)"

Their strategy is seen to be unique and one to watch with one expert saying "they have taken minority stakes but you're under no illusion that Etihad runs those airlines now" (Annexure 4 – Transcript 5)

The benefits of consolidation are well understood and include access to markets and in the aviation industry that includes route access (Annexure 4 – Transcript 1,2,3,5, & 7). One respondent noted that they bought an airline not because it was profitable, but because the deal included very lucrative slots (Annexure 4 – Transcript 2).

Further benefits include foreign investment, access to strong management, and the ability to leverage synergies (Annexure 4 – Transcript 1). For airlines these synergies allow for complimentary scheduling, and redeployment of excess capacity through the merging of two carrier flights on small planes into one large aircraft that can operate with one less competitor, achieving better fleet and asset utilization (Annexure 4 – Transcript 2,4 & 5).

Most spoken of were economies of scale two of the largest expenses an airline faces are the purchase cost of aircraft and fuel. A price point advantage would be possible via bulk buying through a consolidated airline (Annexure 4 – Transcript 1,2,3,4,5,6 & 7).

Further many costs are marginal, to run a frequent flyer for one airline requires similar levels of manpower to running two or three airline frequent flyer programs. This is true for the executive management team too (Annexure 4 – Transcript 5).

They were quick to highlight that consolidation did not equate to a lost brand, they felt if Emirates were to take over or a controlling stake of Qantas, the red tail with white kangaroo was certain to stay (Annexure 4 – Transcript 2,3,& 5). They believed that the reliance for local knowledge, and the passenger's preference for local crews would protect local jobs. They felt that governments agenda could be met through a subsidy into that loss making component, this they felt would be cost effective to government as only that component would be of risk to the state and completely ring-fenced (Annexure 4 – Transcript 5).

There were negative components as well as fears raised with regards to consolidation. Surprisingly, that the business becomes profit driven, this respondents felt could hurt not only the industry but also the country (Annexure 4 – Transcript 2,3,4,5, & 6).

They further said that weaker less mature economies could experience reduced airlift as the conglomerate serves higher yielding destinations (Annexure 4 – Transcript 5). Slots at busy airports such as Heathrow and JFK could also be stripped and reallocated to higher yield business (Annexure 4 – Transcript 2). They believed it inevitable that there would be job cuts and that brand dilution for smaller names was a strong likelihood. Overall they expressed concern surrounding the stripping of assets.

They lastly expressed concern for the consumer, as consolidation would potentially remove competition, which would result in higher fares, negatively impacting the consumer. With less passengers flying because of higher fares, route sustainability also becomes questionable (Annexure 4 – Transcript 2,3,5 & 6).

There were two issues identified whose impact was unknown. Firstly how do you control pace of change if consolidation were to be allowed, as companies who have a strong structural and financial base today would be at an advantage which would not be easily overcome by smaller companies that merged with or were acquired by these larger entities (Annexure 4 – Transcript 1 & 4).

Secondly certain of the larger airlines, which are capable of acquiring airlines such as the Middle Eastern carriers are state backed, can mechanisms be put in place to protect local interests (Annexure 4 – Transcript 5)?

The biggest obstacle preventing consolidation is political (Annexure 4 – Transcript 1,3,4,5,6). The experts felt government would be reluctant to allow for consolidation, especially their state carriers forming part of a larger commercial organisation with profit as its primary focus. They fear the loss of control to use an airline as an enabler, and loss in airlift capability and a dent in national pride.

They fear supremacy of the Middle East carriers, taking over. On numerous occasion Emirates endeavours into Malawi, Zambia and Zimbabwe were cited as a serious concern (Annexure 4 – Transcript 4).

Lastly the belief of troop transport capability is so entrenched in governments throughout the world that a change to that mind set would be unlikely and according to one respondent impossible (Annexure 4 – Transcript 7).

5.2.3. Future report

Based on all the variables discussed in 5.2.1 and 5.2.2 and mapping them with each possible variable a likely future report was generated and presented to each participant for consideration (Annexure 9.1).

Envisaged future:

As it is unlikely that countries will agree on a global relaxation of airline laws permitting true consolidation and efficiencies, there will be a continued move towards consolidation regionally as the next best alternative. This will strengthen the gains made by the global alliances, which were born out of these limitations. Successful examples in the EU, such as Air France and KLM as well as the IAG group including both British Airways and Iberia have paved the way for this likelihood. Other strategies will also be employed such as that of Etihad acquiring minority stakes in various airlines but exercising management control. True globalisation will not emerge in the medium term.

A possible reason for the inability of countries to agree on a global agenda could be pace of change as well as non-level playing fields. Any changes now would favour the carriers that are presently strong, both in terms of structural and financial measures on a long-term basis. A possible solution could be a paced roll out of deregulatory measures. It is also unlikely that the US, which is a major market, would relax ownership laws due to the requirement of troop transport. Other countries would never be willing to allow US ownership of their airlines, without their companies having free access to the world's largest market namely the US.

Finally, developing nations believe that by controlling airlines they can pursue and realise their national development agenda. But they do not realise that by attempting to protect this industry, the long-term result will cost taxpayer money and endanger the same agenda that they are so desperate to protect. There needs to be a mind-set change that protectionism does the opposite of what it aims to accomplish.

In the twenty year outlook, the airline industry will continue as a low margin one. There will be continued overcapacity on popular routes with the only limitation being physical arrival and departure slots. Developing markets will continue to be under serviced with high fares being levied on the flying public. And while state carriers will continue to operate, a lack of a business agenda will see them continuing to accrue losses. This will result in a drain on the fiscus leading to state airline failure which would open a vacuum most likely filled by the Middle Eastern carriers.

Most fears are ill placed and without substance. For example, a country going to war has sufficient access to private airlift for troop transport, as one respondent said "money talks". Furthermore, where there is a market, air capacity will follow. Countries should focus on developing markets rather than developing airlines.

Without a concerted move being made towards deregulation, an unintended consequence could be that nations [who had already begun implementing deregulation] will tighten their policy to stave off Middle Eastern supremacy.

Additional items for consideration:

1.) There is legitimate concern for loss of tax revenue. If airlines were to consolidate, they could move profit's to tax havens. Mechanisms would therefore need to be implemented to prohibit such practice.
2.) Could countries with a development agenda that may include air-lift capacity put out tenders to tender for a service deemed important to the national agenda? In addition, would they be able to provide guarantees for a strictly ring-fenced agenda without accusations being levelled of unfair subsidisation?

In current market conditions, would private airlines or the airlines of other countries be able to provide airlift capacity instead of the national carrier, in markets where these still exist?

5.3. Results: evaluation of the future report

Each participant was asked to complete a survey of five questions to evaluate the report and thereby the methodology, these questions and the results are found below:

1.) Having read the report that you received via email, how accurate do you expect this future report to be?

Rating	Completely Inaccurate (1)	Overall inaccurate (2)	Neutral (3)	Overall accurate (4)	Completely accurate (5)	Overall score
Score	0%	0%	0%	83.33%	16.67%	4.17

2.) The level of insight is

Rating	Non existent (1)	Weak (2)	Average (3)	Strong (4)	In-depth and thorough (5)	Overall score
Score	0%	0%	16.67%	33%	50%	4.33

3.) In compiling this future study, the author considered all of the relevant variables

Rating	Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
Score	0%	0%	16.67%	83.33%	0%	3.83

4.) This report will be useful to my organisation

Rating	Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
Score	0%	0%	50%	50%	0%	3.50

5.) I would consider incorporating General Morphological Analysis as a scenario planning tool in my strategic planning

Rating	Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
Score	0%	0%	33.33%	66.67%	0%	3.67

In measuring the insight into, and utilisation of the parameters discovered, questions two and three were designed to answer the research question 'Can general morphological analysis be used to analyse an industry to reveal detailed insight in all pertinent variables and parameters that could affect the future trajectory of an industry?'

83% of the respondents were of the belief that that the level of insight was good, with 50% of respondents reporting that the level of insight was In-depth and thorough. This result confirms that the methodology when applied can be used to analyse an industry to reveal detailed insight in all pertinent variables affecting the industry.

The second question measured the usefulness of these variables to building a future study. This resulted in participants being split into either being neutral, or agreeing that it can be applied to building a relevant future study. No participant strongly agreed with this statement, and likewise none scored negatively.

The first question aimed to answer the research 'can the insight be utilised in the formulation of a likely future scenario?' with respondents scoring that the outlook built using general morphological analysis from the data collected was accurate. 83.33% felt the report would be overall accurate, whilst 16.67% believed it would be completely accurate. This response is however opinion based, and can only be comprehensively tested with time.

The fourth question was included to evaluate the value placed on the process by the industry leaders and experts to answer the research question 'Would such insight be valuable to an organisation in the design of future and the adaption of current strategy plans?' This question had respondents split 50/50 with half neither agreeing nor disagreeing, and 50% agreeing. Unfortunately no respondent agreed strongly with the statement. Fortunately no responses were scored negatively.

In responses to question five two thirds agreed that through interaction with the process, and access to the results, leaders and experts in the field are more likely to consider morphological analysis as a tool when designing, reviewing and implementing strategy 33% responded neutrally.

Chapter 6 – Discussion

6.1. Introduction

This chapter sets to answer each of the questions posed in chapter 3. To successfully do this, the findings uncovered in chapter 5 are contrasted to the literature from chapter 2 and thereby analysed together with the experience gleaned by the author in working as a future study practitioner.

In undertaking this research the author had the privilege of immersing himself within a general morphological study, and has noted the following observations regarding the process, the methodology and the results. The author wishes due to its significance to disclose that; prior to this research he had never undertaken any formal future study, nor had he previously investigated nor studied any future study methodologies. Further he has no career experience within a future study practice or within the airline industry. The result of this inexperience is that his observations are sans any preconceived ideas, and he experienced the process as a first time participant would in a future study. With relatively few organisations having experience in future studies (Bradfield et al., 2005) this research represents what an organisation might experience when they undertake a future study for the first time.

6.2. Observations

General morphological analysis is a time consuming process that starts with uncovering parameters. In the case of this research this was achieved through one to two hour interviews with senior executives, experts and consultants. Post interview, the recordings had to be transcribed, with the researcher paying careful attention to not only the words but the tone of voice which he cross referenced to the observations noted about the participants' demeanour during the interview whilst typing and analysing the transcripts.

These transcriptions were analysed through computer software called Atlas ti, to uncover the dimensions and parameters across multiple transcripts. Within the corporate environment commercial organisations may not have knowledge of, or access to software such as Atlas ti, as it is focused towards academic endeavours. Secondly an organisation would not be in the position to access sensitive information which could be of competitive advantage from opposition firms within the industry. Despite these shortcomings from an individual organisation perspective, a consultant to the industry could feasibly expect to achieve results similar to that of this research.

Bishop, Hines, & Collins (2007), in their comprehensive assembly of future study techniques highlighted an advantage of general morphological analysis requiring no computer modelling. Although demonstrated to be true through this study, the experience of the general morphological process revealed that the process is exceptionally time consuming and the scenarios told are extremely limited in number. As just 16 future uncertainties were considered to construct the two scenarios used in the report (annexure 9.1), namely one for the bilaterals which was ultimately discounted as unfeasible, and the other for the ownership dimension, consumed in excess of 170 hours. Although the time taken to capture this data into a general morphological analysis model would not be significantly reduced, once completed, the model would be able to consider 65 536 alternative scenarios and be capable of automatically discounting those combinations that are unlikely through a cross consistency matrix. Without computing capabilities only the most likely scenarios are considered and insights that might be contained in less likely scenarios are lost. Given this insight, and the cognisance that this study only considered 16 of the 49 dimensions identified, computer modelling is strongly suggested and the assertions of Bishop, Hines, & Collins (2007) are subsequently brought into question.

The previous research of (Bishop et al., 2007; Coyle, 2003; Duczynski & Williams, 2000; Eriksson & Ritchey, 2002) found that the vast quantities of data uncovered, although rich in insight, was difficult to interpret due to an information overload, that's leads to the tendency of confirming the status quo. This was found to be true of this study, and despite the methodical process of undertaking a general morphological analysis, the sheer volume of possible constraints is overwhelming, further highlighting important parameters in less likely scenarios is found to be challenging as a result of the volume.

The researcher continuously sought validity confirmation of the findings of this future study from experts. Through this experience it is argued that the process requires an expert practitioner. More so, that this methodology would be best carried out in teams of trained future study practitioners with at the very minimum one practitioner who is well experienced in performing a general morphological analysis.

6.3. Addressing research question 1

Can general morphological analysis be used to analyse an industry to reveal detailed and thorough insight into the most pertinent variables and parameters that could affect the future trajectory of an industry? Specifically, what is the completeness of the variables and parameters uncovered, and level of granularity identified?

This study has shown that through the use of an appropriate technique such as general morphological analysis, industry parameters which could have a material effect on an industries future are highlighted, and interpreted through a systematic process of defining each cause and effect, to build complex scenarios of likely and plausible futures (Mietzner & Reger, 2005).

Yet much like the experience of the United States government who have attempted to meaningfully leverage future studies in anticipatory governance, but have failed to do so successfully, due to a state departmental silo mentality (Fuerth, 2009), so too is the experience of general morphological analysis in this research. The methodology when applied to the data collected at each organisation individually was found to be meaningless, and focused on the current objectives of the respective organisation rather than the industry within which the organisation operates as a whole. It requires the insights from multiple organisations within an industry to have deep insight, which can be translated into a meaningful and insightful future study.

The results when reviewing the process from within a single organisation reflected the opinion of the respondent, as well as the current aims and track of that organisation. Groupthink (Janis, 1972) was definitely present in all but one interview with the airline executives, and the effect of single dimension narrow focus was observed (Edman, 2014). It is recommended that decision makers take a step back and consider alternatives on an ongoing basis. As discussed in chapter two, an effective strategy requires continuous iteration. Such adaptation must be cognisant of continuous business environmental changes throughout the industry, review of past performance and be willing to consider the possibility of contrarian views (Richards, 2011).

Of particularly interest was the protectionist tendencies exhibited by all but one of the respondents, despite the fact that the interviews were conducted under the premise of a regulatory review of the airline industry. Notwithstanding the respondents having recognition that deregulation would improve efficiencies, as depicted through the coding (annexure 9.8) which showed deregulation along with consolidation to be the foremost theme of all interviews. Consolidation in itself would be reliant on deregulation, despite this the respondents were unwilling to sacrifice the benefits of certain protectionist regulation they currently enjoy. Like the political law makers who respond with regulation to continuously changing motivations, so too do these captains of industry (Baldwin et al., 2012). Analysing the data from each respondent, protection of regulatory measures would have had near equal prominence to the benefits of deregulation. Only through the meshing of multiple data sources from different organisation, and the variation in views of which protectionist policy is of more importance, could this dimension be ruled secondary to the deregulatory sentiments.

To reliably build meaningful stories of the future, the depth and breathe of dimensions identified must be deep and wide. Sans such insight, future reports will stumble at the outset. Given this, this study has shown that to reliably identify all factors and dimensions which materially affect future scenarios, a data collection mechanism that polls experts on an industry-wide basis is required. Given this and due to the importance of thorough discovery in this the first phase of a future study, the identification of the factors and dimensions is best suited to consultants within an industry rather than an individual within any one organisation.

6.4. Addressing research question 2

Are the experts of the opinion that the insights uncovered are of use in formulation of a likely future scenario with regards to future regulatory uncertainty?

This question could only be answered in the best judgement of each participant. They overwhelming majority of respondents (83%) believe that this report will be accurate. However the future is an unknown quantity and system shocks must be anticipated (Bishop et al., 2007). True measurement can only be undertaken with the passing of time.

Future studies are not necessarily about the accuracy of the report, their value is in the discovery and awareness of dimensions which could have material effect that have not been previously perceived (Mietzner & Reger, 2005).

This question however remains important as it is the believability of the report that leads decision makers to consider the study a valuable tool to aid in their decision making. If decision makers perceive the reports painted through the scenarios are plausible and believable, they are likely to place greater emphasis on the future stories told to sway their perception of the future and the validity of the report (Mietzner & Reger, 2005).

This effect prompted Royal Dutch Shell to pursue further investigations into future studies despite the initial insights of the first report demonstrating no ground breaking paradigm. The commitment into these further investigations paid dividends when the third round of reports compiled in 1973 proved to be hugely accurate, having foreseen the looming oil crisis of the brought on by OPEC (Casey et al., 2014), which prompted Royal Dutch Shell to take action before any of its competitors (Bradfield et al., 2005). Through this initial perception of accuracy the board at Royal Dutch Shell had the foresight and courage to proceed. This foresight translated into a compelling competitive advantage that facilitated Royal Dutch Shells emergence from the crisis as a major oil producer, after entering the crisis initially as a relatively small player (Millett, 2003).

Future studies do require the investment of resources both financial and time but without belief in the output, it will be difficult to influence management to support the process. However as proven by the Shell case it was the perceived accuracy of the first report that facilitated future commitment. Only the third report which benefited through continuous refinement foretold of a looming crisis, a story so unbelievable, that had it been presented in the initial report it might have been discounted as improbable. As a result, this measurement is critical to the success in adoption of future studies and specifically general morphological analysis in the corporate environment. Given this high rate of perceived belief of this report, this study has shown general morphological analysis can generate future scenarios perceived to be accurate by senior decision makers and experts and bodes well for the future adoption of future studies using general morphological analysis.

6.5. Addressing research question 3

Mietzner & Reger (2005) postulate the acceptance and usage of future studies through scenarios but question the applicability to improving a firms performance. Are insights derived from a general morphological analysis study valuable to an organisation in the design of future and the adaption of current strategy plans?

This question resulted in a group split equally in its opinion, half said yes it would be of value, the other half neither agreed nor disagreed. Although encouraged by the group whose assertion was that it would be of value, this research fell short in answering the question comprehensively as a result of the limitations of this research discussed in chapter 7. Without access to a computer model that could model thousands of combinations of the dimensions identified and all of their parameters it was difficult to eliminate groups of parameters and/or dimensions that could not feasibly exist together due to improbability, as well build scenarios in real time that depicted changes in the inputs to the parameters and the parameter themselves (Bishop et al., 2007; Coyle, 2003; Duczynski & Williams, 2000). Should it have been possible to access and build such a model that could've been made available to the participants, a much stronger acceptance in the value of general morphological analysis as a future study methodology would have been expected.

Despite this shortcoming, half of the participants already indicated their willingness to utilise these findings within their own business. This is encouraging due to not only the high office they occupy but also for a number of reasons listed below.

6.5.1. Limited Time

As a result of the profile of the executives and experts of this study, the time made available was limited and as such the report was presented back to the participants in electronic format. The reports length and granularity was thus also constrained. The report generated through general morphological analysis is thought to have been clear and concise enough, to attract their willingness to consider general morphological analysis as a tool they would use for their large organisations in future.

6.5.2. Substantiation

The length specified curtailed the report, in an attempt to motivate participants to complete the final stage process without being longwinded the report had to be limited to four pages and concise. This precluded the inclusion of a case study as substantiation of the applicability and usefulness of future studies, specifically general morphological analysis. Had time and space constraints allowed for the inclusion of such substantiation, the number of experts indicating their willingness to consider general morphological analysis as a tool in future could well have been higher.

6.5.3. Complexity of methodology

General morphological analysis is a complex methodology (Bishop et al., 2007) having provided only the inputs and reviewed the outputs of the process, the experts and executives did not partake in the analytical process themselves. Given this, they could not reasonably be expected to understand the process and give judgement on the actual workings thereof.

6.6. Addressing research question 4

Does an interaction with the process of general morphological analysis, and access to the results from such a general morphological analysis study, increase the likelihood of leaders and experts in the field to consider general morphological analysis as a tool when designing, reviewing and implementing strategy?

Two thirds of the participants agreed that they would consider using general morphological analysis now that they have been introduced to the methodology. As none of the participants had any previous exposure to the methodology and only limited exposure to this process, the resultant report is thought to be not only insightful, but also clear and detailed enough to paint a believable future. This acceptance through the presentation of what was perceived to be plausible, is a feature of baseline, judgement and dimension of uncertainty studies. It is important to note that future studies are not about accuracy (Bishop et al., 2007) but rather about demonstrating and making aware of a likely and plausible future (J. C. Glenn & Gordon, 2003).

The other participants were neither in agreement nor disagreement with the sentiment of using general morphological analysis in their business in the future. The report provided to the participants to evaluate, evaluated the output based entirely on their industry. Due to the high profile and associated time pressures an analysis on the approach and the methodology was not distributed, as it was feared that the true value and insight of the industry report could be lost in a data overload (Habegger, 2010; Ward & Schriefer, 1998). As a result a neutral response was to be expected.

6.7. Conclusion

General morphological analysis has been shown to be a tool that all decision makers should include in their toolbox of aids to assist in the design of robust long terms strategy.

The greatest success however of this research was the acceptance by two thirds of airline industry experts including chief executives who had had no previous exposure to general morphological analysis as a potential future study methodology. Their consideration of the methodology for use within their large complex organisations, based solely on the thoroughness of insight and expected reliability of this future study report is a testament to the robustness of general morphological analysis, especially considering the report was compiled by a future study practitioner novice.

Chapter 7 – Conclusion and recommendations

7.1. Introduction

In this chapter the discussion from the previous chapter is summarised with the aim of closing all the questions asked in chapter three. Further the implications of this research, and the use of general morphological analysis as a tool to aid in strategy design and development within the organisation is discussed. Recommendations for future studies, the limitations of this study and concluding remarks close this critical evaluation of general morphological analysis as a future study methodology for strategic planning.

7.2. Research findings

General morphological analysis can be used as a scenario planning tool when formulating strategy, and the results are believed to be accurate by decision makers within an industry. The trust and encouragement displayed by the senior executives and industry experts reveals that decision makers are in search of and willing to accept additional management tools to supplement their decision making capabilities.

General morphological analysis is however constrained in two major areas. Firstly in access to computing capabilities to process complex systems, on a computer model. Universities have this capability for non-commercial research, but access to the corporate world is very limited as the biggest data service provider in the field namely the Swedish morphological society only makes access available for academic research purposes.

Secondly the research is best carried out by third party consultants. Without industry wide access to data, general morphological analysis results had limited insight of new phenomenon that is unknown to the organisation. One participant when questioned on consultants responded that his only requirements of consultants is to learn something useful that he did not already know (Annexure 4 – transcript 1).

7.3. Research conclusion and implications

It is has been shown that organisations in achieving their goals and aims must have a robust long-term strategy. This strategy must be continuously reviewed and updated as the business environment changes through uncertainty. Regulatory uncertainty was found to be the largest contributor to uncertainty for American businesses when shaping their strategy in a changing regulatory environment ("American idiocracy," 2011). Having knowledge of a likely future aids managers and decision makers to better prepare for uncertainty and unforeseen system shocks.

Although it has previously been accepted that future studies aids organisations in preparing for an uncertain future, and that they could rely on future studies in shaping their strategies, an individual methodology had not been evaluated in strategy design. With so many different methodologies available and future study practitioners' strongly advocating just one methodology, the question do business leaders and decision makers have a specific tool that they can safely rely on to conduct future studies to scan the horizon for dimensions that create uncertainty, specifically in the regulatory sphere, was asked.

This study has shown that business leaders and decision makers can safely rely on general morphological analysis to detect dimensions in their industry which could lead to uncertainty. With acceptance of the methodology, and continuous development in the discipline, organisations will be better prepared to deal with an uncertain future.

7.4. Research recommendations

A future study using general morphological analysis should be undertaken on behalf of the organisation by consultants who have a team of specialist future practitioners who are experienced in general morphological analysis. Such consultants would need to liaise with at least four to five experts in the industry, but importantly outside of the organisation first, to ensure they identify dimensions and parameters critical to future uncertainty of the industry rather than the organisation.

Only once they have established this industry baseline should they consult within the organisation concerned so as not to skew the output report of the future study with issues deemed only pertinent to the organisation. This data should be digitally analysed in a computer modelling software designed for general morphological analysis such as that of the Swedish morphological society.

The challenge to this approach is that reciprocity at the consultant level must be expected. As the consultant is using competitor information to build a baseline on which to model the industry, it is reasonable to expect that the consultant will use the anonymous data of your organisation to build an industry baseline when consulting with your competitors. This can be dealt with under the gambit of normal consultant agreements, but decision makers must be certain that data of distinct competitive advantage is not shared.

7.5. Limitations

The limitation of not having access to computer systems and software capable of building a model proved to be a failure. Only one envisaged scenario was insufficient to reveal novel insights that could be further evaluated by the expert panel of participants.

Without access to computer aided models which can rapidly and accurately build multiple outcomes with only minor parameter changes, an organisation cannot use the outcome of one or two manually constructed futures reliably. This finding confirms the views of Mietzner & Reger (2005) that alternatives methodologies must be sought for small and medium sized enterprises seeking to utilise future studies reliably.

7.6. Suggestions for future research

Future studies could extend this critical evaluation of general morphological analysis as a future study methodology for strategic planning in one of four ways. Firstly a similar study could be undertaken in an industry other than the airline industry, this would serve to confirm these findings are not industry specific.

A permutation to this first suggested study would be to evaluate general morphological analysis again but instead of using industry experts from within the airline industry, to use data collected from up and down stream providers. In this example, aircraft manufacturers, tourism authorities, airports companies the press, travel agents and passengers.

Thirdly the study could be repeated to evaluate another future study methodology and the result of that future study report, compared and contrasted with this one. It would be particularly interesting to compare this report compiled using general morphological analysis methodology, compared to one compiled on the aviation industry using the Royal Dutch Shell method.

The fourth suggestion for future research suggests using the computer model for academic research of the Swedish morphological society to build a computer model that evaluates all of the variables uncovered in this study to tell the story of numerous future scenarios and not only the most likely outcome. It would be interesting to have the participants from this study compare and evaluate those reports with the one contained herein (Annexure 9.1).

7.7. Concluding remarks

This evaluation of general morphological analysis has demonstrated that business can adjust their long-term strategy for competitive advantage to meet an organisations objectives and aims. Through an awareness of all the factors and dimensions affecting an industry, business leaders can achieve a level of readiness to meet the challenge.

Although the Royal Dutch Shell method is the ubiquitous gold standard in future studies, leaders and decisions makers are urged to carefully consider other methodologies as each has strengths and weaknesses. Much like the VHS standard was the most popular standard in home video, for those that understood and enjoyed the benefits of Betamax there was no comparison in home video quality. Likewise to study a future with numerous and complex uncertainties business leaders and future study practitioners are urged to consider general morphological analysis as it is robust and suitable for the task.

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Annexures

9.1. Annexure 1: Industry report provided to participants to evaluate general morphological analysis as future study tool in scenario planning.

In developing this study for the airline industry, the regulatory environment was accessed through interviews conducted with industry experts as well as senior consultants to the industry. Two regulations were identified as onerous and restrictive to airline strategy - the bilateral air transport agreements and the limitations on foreign ownership. Both these regulations were examined to gain an understanding as to why they exist, if they could be removed, and what the impact would be on the industry if this were to happen.

The bilateral agreements are particularly cumbersome to airlines as the ability for executives to manage the airline effectively is hampered by the reliance on the governments of the two separate countries concerned. This is further complicated by the fact that some states who represent their local private airlines in these negotiations are also competitors to those same airlines as they have state run airlines.

The restriction on the ability of airlines to enter a market freely in a globalised world is anti-competitive and protectionist. Some are reporting major bureaucracy and unrelated agenda items being intertwined in these deals. Often the deals are reciprocal where Nation A grants access to country B on the condition that Country B grants its airline equal rights. This means that if either of the airlines performs better, implicitly attracting more passengers, its access will not be extended to meet demand until capacity on the other, less performing, airline is filled.

Over the years, these regulations have been slightly relaxed. In the 1970s on a domestic basis in the United States and in other countries including South Africa during the 1980s and 90s. These were also relaxed intra region in Europe, and between Europe and the US.

In these examples, there have been benefits with the access of passenger to flights improving whilst simultaneously the new entrants forced fares to decrease improving customer welfare. However on the downside as it is difficult for airlines to differentiate themselves. A fare race to the bottom ensues which results in numerous entrants being forced to exit through bankruptcy and overall market upheaval in lost reliability as well as lost airlift capacity. Without barriers to entry, a vicious cycle ensues.

The current move to route liberalisation has been localised only. Through this, there is no opportunity for foreign direct investment and has seen only local benefit's. Countries with open skies are able to limit and restrict movement through the granting of or refusal of airport slots which is the right to take off or land at an airport, and allow other limitations in the form of the allowance of strong airlines to form alliances with so called antitrust immunity, circumnavigating anti-competition laws.

The second dimension considered was the restrictions on foreign ownership. There was overwhelming consensus that the airline industry in its current format is burdened by overcapacity and inefficiency, especially in developing markets. It was postulated that consolidation could cure many of the ailments prevalent in the airline industry.

An often-cited example during the process was that more than 240 airlines in various shapes and sizes exist within Africa. Only a handful of these carriers are making any impact in stimulating the development agenda, economy, and the people of each nation. Furthermore, they are operating at financial loss, endangering not only their existence, but also potentially compromising passenger safety.

To combat this inefficiency and overcapacity, most respondents agreed that there would be consolidation going forward. The major stumbling block to this occurring is the current ownership regulation regime.

If consolidation were to occur, the benefit's would include efficient asset utilisation, the opportunity to implement bulk buying of fuel, fleet, back office infrastructure, the implementation of strong management teams, foreign direct investment, and the ability to redeploy excess capacity efficiently.

Tempering these benefits are the concerns and fears that are envisaged in the foreign ownership of airlines. These include:

1.) Merging airlines would result in less competition in the market thereby leading to a negative effect for consumer welfare.
2.) Asset stripping including the selling of slots or the reallocation thereof to more profitable routes.
3.) Loss of local jobs, especially within South Africa which has high levels of unemployment.
4.) Loss of airlift to and from the country, as well as specific cities within the country.

Politically fears would include:

5.) Loss of influence on a locally-based carrier.
6.) Loss of a flag carrier, and the belief that the nation requires a flag carrier.
7.) Loss of military airlift in times of war as foreign-owned carriers would be difficult to commandeer.
8.) The belief that through its fortuitous geography and low cost base, the Middle Eastern carriers are poised for global supremacy, and cannot be beaten.

For the industry to allow consolidation through relaxed ownership laws, the following measures and conditions would need to be realised:

1.) A globalised view and unified stance on the airline industry, with a move to a globalised airline industry.
2.) Strong competition law that can be enforced globally. This would protect the public from these newly-formed conglomerates and offset any calls of anti-competitive behaviour.
3.) Political will and buy in. This is the most challenging to achieve as the view of

governments and their desire to control the industry based on invalid beliefs are long entrenched.

4.) Change in mind-set. “Everyone has an opinion on how an airline should be run” was one of the quotes shared by a senior executive. Government, the taxpayer, passengers, and laymen all have something to contribute. But all commentary is made sans the paradigm shift which is urgently required. Is there a case for countries needing airlines with national links any more than any other industry? Why can two private Japanese firms such as Canon and Nikon service the photography needs of the world without regulation, restriction, and control?

5.) Agree upon the schedule for a rolled out implementation. Change in itselfleads to the onset of extra fears and concerns. In developing markets such as Africa, a belief is held that strong carriers in the US, Europe, and the Middle East will dominate on a long-term basis if these globalised airlines were allowed. There would therefore be no opportunity for these markets to ever establish dominance in the long-term.

Envisaged future:

As it is unlikely that countries will agree on a global relaxation of airline laws permitting true consolidation and efficiencies, there will be a continued move towards consolidation regionally as the next best alternative. This will strengthen the gains made by the global alliance, which were born out of these limitations. Successful examples in the EU, such as Air France and KLM as well as the IAG group having both British Airways and Iberia have paved the way for this likelihood. Other strategies will also be employed such as that of Etihad acquiring minority stakes in various airlines but exercising management control.

A possible reason for the inability of countries to agree on a global agenda could be pace as well as unlevel playing fields. As already indicated, this would favour the carriers that are currently strong on a long-term basis. A possible solution could be a paced roll out. It is also unlikely that the US, which is a major market, would relax ownership laws due to the requirement of troop transport. Other countries would never be willing to give up their control, without their companies having free access to the world's largest market - the US.

Finally, developing nations believe that by controlling airlines they can pursue and realise their national development agenda. But they do not realise that by attempting to protect this industry, the long-term result will cost taxpayer money and endanger the same agenda that they are so desperate to protect. There needs to be a mindset change that protectionism does the opposite of what it aims to accomplish.

In the twenty year outlook, the airline industry will continue as a low margin one. There will be continued overcapacity on popular routes with the only limitation being physical arrival and departure slots. Developing markets will continue to be under serviced with high fares being levied to the flying public. And while state carriers will continue to operate, a lack of a business agenda will see them continuing to accrue losses. This will result in a drain on the fiscus leading to state airline failure which could open a vacuum most likely filled by the Middle Eastern carriers.

Most fears are ill placed and without substance. For example, a country going to war has sufficient access to private airlift for troop transport, as one respondent says "money talks". Furthermore, where there is a market, air capacity will follow. Countries should focus on developing markets rather than developing airlines. Without a concerted move being made towards deregulation, an unintended consequence could be that nations [who had already begun implementing deregulation] will tighten their policy to stave off Middle Eastern supremacy.

Additional items for consideration:

3.) There is legitimate concern for loss of tax revenue. If airlines were to consolidate, they could move profit's to tax havens. Mechanisms would therefore need to be implemented to prohibit such practice.
4.) Could countries with a development agenda that may include air-lift capacity put out tenders to tender for the required service? In addition, would they be able to provide guarantees for a strictly ring-fenced agenda without accusations being levelled of unfair subsidisation?
5.) In current market conditions, would private airlines or the airlines of other countries be able to provide airlift capacity instead of the national carrier, in markets where these still exist?

9.2. Annexure 2: Results from feedback on the report by airline experts

1.) Having read the report that you received via email, how accurate do you expect this future report to be?

Completely Inaccurate (1)	Overall inaccurate (2)	Neutral (3)	Overall accurate (4)	Completey accurate (5)	Overall score
0%	0%	0%	83.33%	16.67%	4.17

2.) The level of insight is

Non existent (1)	Weak (2)	Average (3)	Strong (4)	In-depth and thorough (5)	Overall score
0%	0%	16.67%	33%	50%	4.33

3.) In compiling this future study, the author considered all of the relevant variables

Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
0%	0%	16.67%	83.33%	0%	3.83

4.) This report will be useful to my organisation

Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
0%	0%	50%	50%	0%	3.50

5.) I would consider incorporating General Morphological Analysis as a scenario planning tool in my strategic planning

Strongly disagree (1)	Disagree (2)	Neither disagree or agree (3)	Agree (4)	Strongly agree (5)	Overall score
0%	0%	33.33%	66.67%	0%	3.67

9.3. Annexure 3: Interview Schedule

Type of study: Exploratory and explanatory (semi-structured)

Instrument: Note Pad, Audio recorder

Interview guide format: Flexible depending on the experience during the actual interview, follow-up with any new questions raised.

Preparation in advance of the interview

Before the interview, the interviewer should prepare or plan for the following:

- Be punctual, courteous and explain the entire process before starting include items such as :
  - Consent form (present and obtain signature)
  - Advise of their right to withdraw
  - Recording of the interview, and reasoning.
- A suitable location should be used - choose a comfortable setting, convenient for the guest with no distractions.
- Start the conversation by discussing the industry and demonstration of my strong interest in their industry to build a positive rapport.
- Ensure that thorough research on the person being interviewed is done in advance of the interview.

BACKGROUND

- Listen! No preconceptions.
- Be flexible and change as the interview progresses to extract maximum value.
- Be aware of body language.
- Do not lead the answers
- Record answers verbatim.
- Show no reaction to the persons answers
- Remember their answers are perceptions, and not tested fact.

- Probe answers that are vague, that require further understanding or more specific answers.

During Interview

Hello my name is Simon Swanich and I am conducting this interview in partial fulfilment of my Masters of Business Administration degree at the Gordon Institute of Business Science.

The purpose of this interview is twofold; firstly today I am here to understand the process of a consultant who would consult to you. My interest is not in your airlines own internal strategy but more so in your opinions as an expert in the field. This information will be used to build a case study, which I will use as a proxy to the consultative business management process. After the interview if you would be so kind as to evaluate the case study report which I will send to you electronically.

Administration

- Explain the format of the interview.
- Indicate how long the interview usually takes.
- Provide contact information of the interviewer.
- Ensure that the respondent consents to the interview being conducted and signs a consent form
- Seek further consent from the respondent to record the interview for transcription records.
- Allow interviewee to clarify any doubts about the interview.
- Prepare a method for recording data, e.g., take notes and setting up of two recorders.
- Discuss and agree on terms of what will be done with data from the interview.
- Explain process of data collection and analysis.

This interview should take no more than one hour. Please answer the questions to the best of your ability.

As we have already discussed the process is of importance to me, your specific answers will be kept strictly confidential, as I will not be recording specific identifiers.

You are free to stop participating or withdraw at any time. Let me know if you would like to skip a question for any reason.

Are you comfortable with the fact that I am recording the interview?

May I start the interview now?

[Start Recording]

Whilst asking questions:

- Record observations of a non-verbal nature to supplement and contextualise the recordings on the audiotape.
- The format of the interview is semi-structured with some pre-planned questions below, while allowing for a natural free flow of conversation and questions.
- Seek understanding and interpretation of what was heard.
- Search for a deeper understanding and clarity from the respondent throughout the interview.
- Encourage responses.

The research questions, which need to be addressed in the interview, are as follows:

1a.) In terms of ownership, and the so-called 'air freedom points' airlines operate in a well-defined regulatory environment. Are these regulations onerous of airlines?

1b.) Do you see these regulations as harmful or beneficial to the industry?

1c.) What is your reasoning for that assertion?

2a.) In terms of the ownership / air freedom points dimension, which do you see as more important to your [positive/negative] stance?

2b.) Why does [said dimension] have such an impact?

2c.) If you had to amend any part of this regulation, are there perhaps a few points that you would specifically change if given the opportunity?

2d.) What would be the benefit in making such changes?

2e.) If your changes could be implemented tomorrow, what would be your response?

2f.) How do you think your competitors would react to the changes you proposed to the regulations?

2g.) How do you envision the competition would respond to the changes you would make as an airline in light of these amended regulations?

3a.) Could we consider for a moment the [other dimension]? Do you see this dimension as having an impact, and if so is it positive or negative?

3b.) Why does [other dimension] have such an impact?

3c.) If you had to amend any part of this regulation, are there perhaps a few points that you would specifically change if given the opportunity?

3d.) What would be the benefit in making these changes?

3e.) If your changes were to be implemented tomorrow, what would be your response?

3f.) How do you think your competitors would react to the changes you proposed to the regulations?

3g.) How do you envision the competition would respond to the changes you would make as an airline in light of these amended regulations?

4a.) What are your thoughts surrounding complete deregulation of ownership controls and the air freedom points?

4b.) Do you think deregulation should occur?

4c.) Should it occur, would the industry as a whole be better post deregulation?

4d.) Would all airlines experience a [positive/negative] affect, or will there be some winners and some losers?

4e.) [If applicable] What characteristics would distinguish the winners from the losers?

4f.) Do you think complete deregulation will occur?

4g.) [if no] Do you think limited deregulation will continue?

4h.) [if yes] In which area's

5a.) Would you like to add any thoughts or variables for me to specifically consider when I compile my report?

6.) Could you explain any previous interactions with consultants you may have had in this field, short comings, and successes

Lastly – the industry is very small in South Africa, could you put me in touch with other executives at other airlines whom I could meet in person or via a telephone interview? If not are there consultants in strategy who you or your airline uses that I can meet?

That is the end of the formal part of the interview. Do you have any questions? Should the need arise could I make contact for clarification?

Once again thank you so much for making time available to meet today, I appreciate your contribution and look forward to sharing my findings with you.

9.4. <u>Annexure 4:</u> Transcripts

9.4.1. Transcript 1: Interview with CEO at South African based airline

The first question is regarding air freedom points and ownership regulations. Do you find these onerous of airlines or do they enable airlines?

Well at the moment domestically there is a requirement for 75% ownership control and one can argue that that in itself is an inhibitor to growth and that the same time it's an objective that has been long-standing and it arises from the original Chicago convention of 1944, and it's objective is to try and retain local ownership and control of domestic airlines specifically.

The argument is: the industry has becoming globalised and there are prospective investors that have appetite to establish network systems at the domestic level and for that matter at the regional level, establishing bases in places like Johannesburg international airport and if that local ownership and control rule were relaxed it would encourage more objective direct investments the likes of fast jet for example or Etihad and emirates would have appetites to invest and that can only all go well for the consumer. So I would say the current rule is too onerous and should be relaxed were possibly following other states in Africa and other places around the world it should move from its 75% local ownership down to possibly 51% local ownership.

We spoke of it being harmful to the consumer and there would be greater consumer welfare should the laws be relaxed, from an industry point view how are the current players affected should laws relax tomorrow?

The current players would go under threat, the industry is globalising and you have massive players like emirates who are investing enormously in the establishment of massive network systems that reach all over the world and by extension they would need to get to points beyond the nodes to their hub, a node being Johannesburg the hub being Dubai, they need to get to points beyond the node, so for us Johannesburg is a major hub but for them it's a secondary node, and i think that if the system were setup it would appeal to established globalised carriers like the likes of emirates and I think it would become a threat to the local established carriers, no it doesn't mean it's entirely it's a threat it could be an opportunity for example a carrier like an RegionAir that has a fairly big feeder network system footprint, it might be appealing to the likes of Etihad or a emirates so alliances can be formed and there can be an heightened levels cooperation.

An alliance in terms of the three big alliances or terms of joint ventures?

Probably in terms of JV's, emirates sit's on its own, and on its own is bigger than some of the big alliances, being the star alliance and Skyteam, so i think some form of the jv where you get a carrier like an RegionAir that can have a 49% ownership by a carrier like an Etihad making it worthwhile for an Etihad to invest in an RegionAir, in order that an RegionAir can expand it's business footprint throughout the sub region on a network system basis. So at 25% I think the incentive for foreign direct investment into local airlines is less.

What is your feeling on that 49/51 becoming 100% foreign owned?

I don't have a problem with hundred percent foreign ownership either, I think the transportation industry throughout the world is globalised, it's really globalised and we as South Africans and Africans I think need to get with the program and you can't be resistant it's coming, so if we keep on with these prohibitive regulations all we doing is we resisting it, but it's coming.

You spoke about emirates, an argument has been made is the African countries through the Yamoussoukro agreement of years ago, with the idea of liberalising within and between African nations. How do you interpret the argument that it's benefited emirates and the Etihad's and it hasn't really had the desired effect for the African countries?

That is absolutely the case, the whole idea of Yamoussoukro which has a history back into the 1980s really because the first Yamoussoukro was declaration was in 1988 and then the decision to implement the declaration came along 11 years later in 1999 and it's just been very slow on the uptake and not in how it has been documented because the first document of Yamoussoukro was in fact liberalisation, the second document was a decree to implement that liberalisation which they declared 11 years earlier. I think the fact that it hasn't been holistically implemented throughout Africa epitomises the pace at which Africa develops, and there is some fundamental reasons as to why it's quite slow. I think the first observation we need to recognise is that Africa has 54 states and therefore there are 54 sets of political boundaries, there are also at least 54 sets of national airlines in fact there are 243 according to IATA, airlines established in Africa and it's just incomprehensible that we have that number of airlines serving an Africa market of approximately billion people not all of whom travel. The number of people travelling around Africa are less than 10% of that population so, i think the fact that there are that 54 political boundaries is one of the reasons why realisation hasn't happened at the pace, the holistic dropping of the boundaries pace that everyone would like to have seen. But at the same time, it has liberalised, Africa has liberalised and i can vouch for it from an RegionAir perspective we've got access to markets which previously didn't have access to, a lot of markets Mozambique were not available to us and the more gradual approach to liberalisation is probably in many ways a more responsible approach so that you don't take the investment that has been made, serious investments made by states as in the case of their national airlines and basically squandered that. At the same time your national airlines have to move over make way for more efficient airline transportation systems the likes of RegionAir which when they do address markets apparently have the ability to do so with much more agility and much more effectively and better at cheaper prices, more reliably, more punctually, thereby doing it more efficiently than what national airlines have been known to do.

If we look at the regulations and we separate ownership from the air freedom points which of those is more important in terms of regulations falling first?

Because there is a correlation between the two. In essence what happens is the reason why there is accelerated deregulation is because of protection of state-owned enterprises, more specifically. No state protects private airlines, the states go out of their way to protect state-owned enterprises and i think that's probably where the deregulation needs to start. By abandoning state ownership or reducing state ownership of airlines as in the case of KQ Kenya airways, the state still has a small statement in that airline but the state is not the owner of the airlines, it's privately owned and it got some direct foreign investment in the part of KLM is an investor and i think that there you will note that there is a greater degree of liberalisation between Kenya and other African markets happens to exist where the state has part of it's objective the protection of the state owned enterprise.

If you had the opportunity to amend these regulations, what would you specifically amend as regards ownership?

I don't know that I would put a restriction of ownership. Why? If an airline can demonstrate all of the other elements, all the other criteria, if it can demonstrate compliance with such criteria, financial hygiene, operational safety hygiene, insurance, consumer protection, especially with the mobility of executives and accountable officers now days, why should it not be fully liberalised from an ownership point of view? Why should they be any constraint or prerequisite? Does it really matter? If you have a look at a company that happens to be listed on the stock exchange how do you determine it's local ownership and control in the instance of a listing? In that would apply anywhere around the world, a British airways or any airline anywhere. How do you know what the composition of the ownership is once it's listed on the stock exchange? The fact that the stock exchange happens to be domiciled in that particular place does not necessarily give it ownership locally. So i i think it should be opened up completely so that to your point that's the one thing that i think should happen it doesn't matter where the ownership is.

If it were to happen tomorrow what would be benefit's to both the industry and consumer?

Well I think would become attractive to big international airlines, who may have the appetite to see their franchise systems extend throughout the sub region, would see an opportunity to invest in local companies like an RegionAir and would invest in that RegionAir, it would obviously boost RegionAir in terms of the nexus that it would have with that investor and also in terms of the capitalisation that may be available and all of the other advantages that would stem from that, for example collective purchasing, becoming part of a much bigger air transportation system, global distribution, franchising, operational safety, standards determination, training revenue accounting, all sorts of things would flow and those benefit's would ultimately end up in the hands of the consumer. Also it would be useful i think to the consumers at the local and regional level, to have international brands, which have permeated other territories as well. For example it seems Etihad have dropped its anchor in Europe at several points and you operate seamlessly from an Etihad or emirates flight for that matter but Etihad in particular because it goes to beyond the node through Europe it's got several points in Europe where it's established nodes to get access to beyond markets beyond those nodes.

If this happened tomorrow, what would be your first response?

Well we are aligned at the moment and happily so, we a franchisee of Blue Diamond air and I guess we would need to take stock of maximising the value of RegionAir to all of it's stakeholders and we need to do some soul-searching as to whether our value is maximised in the current structure, the current alignment that we have, i would suggest that there may be, more appealing relationships, potential relationships available to RegionAir, and I guess we may wish to explore those. We been tracking the progression of the emirates network system throughout Africa, and how it has encroached into southern Africa, points like Dar es Salaam and Lusaka and Harare and Luanda specifically and I'm fairly sure that's not going to be where it's going to stop. An opportunity for a regional airline like an RegionAir would be to align an aggressive global carrier like an emirates and feed in and out of the emirates nodes holistically as opposed to only in and out of Johannesburg for and on behalf of BLUE DIAMOND AIR and their international partners: star alliance and others through IATA, or both of those. So not to abandon the current relationship but to extending to new relationships the likes of emirates would be appealing to us and use that as an opportunity to further develop the RegionAir system. Which would entail RegionAir getting invested, in foreign domains like within states in Africa, Zambia and offering domestic and regional services based in Zambia but branded on the RegionAir brand. So those are the kind of opportunities we can see and by the way we are already seeing those opportunities so it's not is not limited to ownership. We see that we can work within the current local ownership structures of those domains not necessary South Africa.

Do you see your airline as having direct competitors?

We do, we have a direct competitor which is aligned with the Blue Diamond air in a similar franchise relationship to us at the moment and I find that is a nonsensical competitor, because all it's doing is replicating exactly what we do and vice versa and it destroys value and doesn't add anything to the consumer and it doesn't add any value to either of the two operators it's really just as i say destroying value. Do we see other direct competitors? Yes we see direct competition in the form of Iam, air Zimbabwe, air Botswana, Air Namibia competing with us in certain markets, so we do see direct competition Air Madagascar is another direct competitor, but one of the things that we have which counters that competition is that we are an airline that is a single entity competing with all of those single competitors simultaneously and having the mass and efficiency to do so effectively.

If you had to garner investment from emirates tomorrow for example, Iam, air Zimbabwe, air Botswana, and air Namibia how would they react? Would they try to also get investment?

I think none of them would have the appeal that an airline like RegionAir has. First important thing us that we offer 37 destinations, mostly hubbing out of Johannesburg, whereas most of the airlines offer services in and out of Johannesburg in replication of what we do, we can offer 37 points whereas each of those respectively can offer maybe one or two points only. I'm sure that they would be trying to court some relationships, but I don't know they would be appealing as the RegionAir network system offers appeal obviously they free to do what they wish to do and what they need to do, bit I just don't know that they can offer the same as what we can offer.

Comprehensive network system 37 destinations most which are out of Johannesburg international airport, 40,000 flight missions a year, 1.2 million passengers which are trained into our system, a lot of our destinations are exclusive destinations, well either exclusive and or competed by with one other operator as in the case of a Maun in Botswana or a Kassane Botswana, Tete Mozambique, nobody else can offer that so it would be highly appealing and once that system is aligned with someone like an Etihad or an emirates or anyone else like Skyteam which is also very appealing star alliance is also appealing, anyone of those very appealing sometimes you have to wonder "do you want to align with one or do you align with everybody?" once you have dominance at a hub like a Johannesburg for example and you have 37 destinations with 40,000 frequencies then there is an argument that says you don't need to align, just do what you do for everybody who has an appetite to interline with you. We have seen that example elsewhere, way we've seen an operation in St. Louis Missouri styled "trans states" grow to an operation entailing several hundred aircraft, it owns the regional feed system in and out of St. Louis Missouri which is not as big a hub as a Chicago or an Atlanta but nonetheless it is a good interchange node and they been able to develop the business to a couple of hundred aeroplanes and they align with everybody that operates in and out of St. Louis. Every one of the major operators like continental for example us airways, all operate in and out of St. Louis and then they align themselves with those operators on an interline basis.

If we focus on the bilaterals do these and if so how do these impact on your business?

They do, they constrictive, typically bilaterals regulate the take-upof capacity between the two states and regulate which airline or airlines are designated as the designated carriers of that particular state. Typically the market dynamics with much more quickly then the aero political and administrative aspects that supports the carriers that operate on those markets so we normally end up with a begging bowl to the regulator, which is really the department of transport in this instance and try and get them motivated to free up capacity as and the market requires that, and we have got a couple of those instances, for example Maun, we moved on to Maun just over two years ago and already we dominant by 80% because of operational efficiencies and pricing but most specifically because of punctuality performance, service delivery in other words, and we need more capacity and to get more capacity allocated to us is a whole process, entailing not just our department of transport, but their reciprocal department of transport in Botswana and very often the Botswana department of transport may turn around and say no we don't have an appetite for it because until there is an equalisation of the opportunity between our national carrier and South Africa's designated carrier which happens to be RegionAir in this instance, they don't really have an appetite to open up any more capacity on the route. It's a forced equalisation, it's not market natural equalisation, there is no market natural equalisation, the market will basically support the carrier that operates most effectively and delivers the best service product to the consumer and that happens to be us in this particular instance as is demonstrated by the fact that we are a 80% dominant on that route after only being on that route for just over two years. I give you many of those examples.

If we focus on that example is your bilateral for a number of landings or a number of seats?

That varies by bilateral, sometimes the regime is a seat regime, sometimes the regime is a frequency regime regardless of seats. So in the case of Mozambique most of that regime is a seat regime it controls the number of seats that get allocated and controls a number of frequencies, so both of those are constrictive.

Given the choice you would want the frequency?

Well given the choice we would like the market to dictate as to when we increased capacity and frequency. So we wouldn't like there to be any restrictions at all. Of course we also get the benefit of the restriction so if it was a free for all, sometimes markets get upset by having too much capacity irresponsibly, to quickly and we have seen that all to often. What we support as an airline is responsible competition, how do you get responsible competition when you've got flagrant disregard for a lot of factors that determine or underpin the meaning of the word responsible. For example the companies act, in this particular instance we've got state-owned carriers that are irresponsibly trading at the moment, if they were private businesses they would have to shut down or they would have to file for business rescue, and they not doing so, they keep on cap in hand to treasury for more bailouts, that's irresponsible trading, so we support responsible competition, we don't want mavericks or cowboys in the system, and you do get them from time to time they come and they go but you can't have the cowboys being the state-owned enterprises. At the moment the industry is lead by bankrupt state-owned enterprises should not be in business.

If the state-owned enterprises were given an opportunity to exit the market, would there be players able to step in and fill the gaps or does the state need to project the industry, that perhaps can't fail?

I think in terms of capacity there wouldn't be private capacity to replace the state-owned capacity overnight, so there would be a vacuum. At the intercontinental long haul level you've got bigger, more powerful carriers the likes of emirates that could step up to the plate almost overnight so if BLUE DIAMOND AIR had to withdraw from all of its global network then other international carries the likes of emirates, Etihad, British airways, air France, Lufthansa would step up to the plate in no time at all they would fill the capacity void left by BLUE DIAMOND AIR soon, at the local and sub-regional level, it may take a bit more time and i think one has to think about the impact on the economy holistically of a radical change event like a Blue Diamond air going out of business overnight I think it would be devastating for the economy and i think it needs to be managed a bit better than that. I think if the intent of the state is to withdraw from its investment in its ailing state-owned enterprise airline; Blue Diamond air which does consume a lot of taxpayers funds from the fiscus, then it needs to be managed over time and the private sector needs to be encouraged over time to build enough capacity such that eventually, when the rug is pulled, that it doesn't have such a decimating effect on the economy.

So pace?

Yes! Can it happen? Yes, when? Not today. It can happen absolutely and one has to recognise that the Blue Diamond air air transportation system is a composite system including other components to the composite it's a component of the composite, express is a component of a composite, mango is a component of the composite, and RegionAir is a component of the composite, if you have to take each of those components as individual separate entities, they probably do need the whole composite to survive, not so much in the case of SA express but certainly in terms of the relationship with RegionAir and Blue Diamond air and Mango and Blue Diamond air, i think that there is a symbiosis which should not be ignored. That symbiosis can be replicated by RegionAir aligning with Skyteam, Oneworld, emirates, Etihad or all of them, but it needs to replicate the composite system and the benefit's of the composite at each of the components of the composite and that can't happen overnight.

Just to clarify, you said deregulation in terms of the ownership and the air freedoms need to deregulate at some point but it shouldn't be a mass event it should be a paced event?

Well deregulation is already a gradual process and i think the word Yamoussoukro is probably often over bandied around, liberalisation has happened, is happening, but it's happening at the pace that states can afford to let it happen without having their markets stolen away from them encroached from the national carriers and so on and so forth. I think as regards ownership is concerned the national carriers need to take some soul-searching as to whether they should stay invested in state-owned enterprises, and that principal needs to be applied holistically throughout Africa, we've got 54 states in Africa you can't have 54 state-owned airlines in Africa, the size of the African market can probably support less than 20 airlines throughout the whole of Africa, at the moment we sit with 243! It's far too many, there needs to be some rationalisation of the systems that are currently all trying to eke out a sustainable viability from an industry that can support a fraction of what it is currently trying to support in order for the industry to grow there needs to be rationalisation and consolidation and then growth so that you've got airlines operating at or above their critical mass, been able to permeate all countries throughout Africa and natural nodes will establish, a few in the south where there is concentration of economic viability and possibly what we have already in the north and east in the form of you Ethiopia at Addis and KQ at Nairobi but there is absence system at the moment and an opportunity to sustain at least one node in West Africa I say probably two nodes in west Africa, like a Dakar and Ghana Accra, I'm not so sure about Lagos, it's a bit more chaotic to do business there but Accra's ripe fruit, and has been quite some time for me it's just a wonder as to why it hasn't actually.

What about a player from the south having a secondary hub?

In West Africa?

Yes?

But I think it's bigger than a player in the south i think a player in the south can catalyse it, but it can only make it viable on the basis that the player from the south hooks up with players from Europe and from North America and all over the world including the Etihad's and the emirates, all accessing the same node, so establish a hub in West Africa and establish a hub and spoke "regional feeder system a transportation system like an RegionAir, in and out of that hub in West Africa, linking more significant points with each other with that hub, in other words Accra, and Abuja, and the less significant points, so that you establish a starburst network system at that hub with flights pulsating in and out of that hub coordinated and synchronised in order to make interline connections with all of the carriers operating in and out of that hub, all holistically operating in and out of that hub within a system, and then it can work but unless it's co-ordinated and systemised it's not going to work

Would a hub system like that work in Johannesburg given our geography?

Johannesburg is extreme and Johannesburg is a hub and spoke transportation system already and RegionAir is a component of it. Johannesburg would want to link with that West African node, and that West African node would want to link with other nodes like Johannesburg throughout the world, East coast North America, Atlanta maybe or new york or wherever, points in Europe Frankfurt, Paris, London, it would need to link with those and then it needs to have his own micro network system which will operate regionally around that particular hub, so Johannesburg wouldn't want to replicate what goes on there, and you wouldn't want replicate there what happens in Johannesburg, save to say that you want to establish a network system which pulsates in and of that node Accra, where that nodes connects with other points of significance like a Johannesburg, Frankfurt Paris etc, but that that node also establishes a network system at the regional level, and that can work in my view, that is what's working down here, that's what works throughout the world, it's absent there, it's already working in Nairobi, Nairobi has got a very well established hub so to Addis Ababa and you will find that there is a linkage between Addis and for example Cairo, Addis and Johannesburg, Addis and Frankfurt, Addis and Paris, Addis and London and then from Addis there is a starburst that goes intra Africa and especially locally and regionally, around Addis Ababa and that's the reason why Ethiopian is doing well it's because it owns a network system, like Blue Diamond air should do much better than it does- it owns a network system, and it's got partners in the network system like RegionAir it should do much much better because of the accessibility of markets through that network system

In terms of the industry the airline players within the industry, if we had a system of opening up would the industry as a whole be better?

I think the industry will go through radical change, and it will open up the opportunity at the same time that opportunity will be a threat to some, so i think that the fittest and those that are agile and capable of undergoing a change would turn would benefit from opening it up. It might transform the industry, sorry, it will transform the industry.

So agility would distinguish winners from losers?

You have to be dynamic you have to observe the market and you have got to move quickly, i have always maintained you get the quick, and you get the dead so choose one of those, if you not quick you going to die.

A few minutes ago we spoke that the deregulations are already happening and it's happening at various places around the world, do you think we will ever get to a point where it's completely deregulated?

I don't know that Africa is ready for complete deregulation, as long as the 54 political boundaries in Africa and 54 states each wanting to support it's own state owned enterprise I think that that in itselfwill be the inhabitant, so when Africa starts to recognise that it's political boundaries have to drop for economic imperatives then my sense is that Africa may be more aligned to a full liberalisation and the establishment of a few stronger airlines, than it's 54 ailing state-owned enterprises at the moment, plus the 243 airlines that are all trying to eek out a living. Africa does not currently have a propensity for a free market system.

Looking forward 30 years do you think that changes?

From my current perspective probably not, I see the pace of change in Africa is far too slow it goes about this aspiration of each current country wanting to have it's own carrier. It's entrenched it's almost like a status symbol.

If we look outside of Africa, Asean, South America, they on track for complete deregulation?

Yes. That's where Africa needs to go to, but the biggest barrier is the political boundary.

So Africa could be the last frontier in terms of deregulation?

It is. Even if you take a look at what's happened in South America, one of the catalysts to the change in South America was Brazilian government's inability to carry on funding Varig and it had to drop the ball on Varig. Varig blew over and suddenly you found the emergence of a whole lot of carriers and with deregulation forced because of the absent varig, suddenly you've got lam which has open up right throughout South America and it's a conglomerate it's an airline network system with multiple ownership, and airlines domiciled in various countries but all working together under a common brand, with a common cause in an network system interline way and that needs to happen in Africa. I think it is starting to happen but it's not got traction, in the same way as what happened with that catalysing event of the demise of Varig in Brazil. The

Brazilian market is a lot bigger than the South African market, brazil has got over 200 million people, so it’s market is probably four times the size of the South African market.

Would the demise of BLUE DIAMOND AIR result in a Varig type situation?

It would catalyse a radical change. Yes.

Based on the questions I have asked you have a feel for the report I am writing, are there any variables or levers I should explore that would be interesting?

Well you have to think about the funding aspect of it, because at the moment you right BLUE DIAMOND AIR is the obstacle. As it just so happens RegionAir relies on the relationship with BLUE DIAMOND AIR, but if BLUE DIAMOND AIR were to fall over tomorrow we would shift that allegiance to someone else, maybe BA, maybe Etihad, Emirates wherever. But if you have a look at how is funded at the moment and it's a massive drain on the fiscus, and that has to be the rhetoric at what point is the government going to wake up to the fact that there is no need to keep propping up a Blue Diamond air, why the doing it? I think that may come along in tranches the first step of it as why on earth is the government keeping up propping up SA express? They definitely don't need SA express, it brings nothing strategic of value to the state, SA express is constantly pitching itselfas a developmental role player, but what exactly is this development role? It says that it takes black kids from underprivileged areas, there is an official scoring system as you know... BBBEE, it doesn't even score the BBBEE scorecards, if it’s not generating profit’s and is not sustainable then what real developmental role can it play? What investment is it making in corporate social responsibility, in enterprise development, in skills development, in ownership, and and and, it may fulfil one or two of those criteria only out of 7 areas, but it's not a holistic approach to developmental whereas a sustainable business like RegionAir in order firstly to become sustainable has to comply with the BBBEE scorecard rules and you have to be committed to it, and if you are sustainable and viable than you're ploughing your profit’s back, the more profit’s you make the more you plough back into the system in a developmental role.

You said SA express has no strategic role?

No strategic value.

Would you BLUE DIAMOND AIR does have?

I think in a declining way at the moment the government sees Blue Diamond air as an important carrier of the South African brand to destinations like Beijing for example, I see it's role being completely different. If it wishes to create access, then it can get access not to Beijing, but to all of East Asian markets if it were to team up in relationship with an Etihad or with emirates or a Singapore or a Thai or whoever, it doesn't need to carry it's brand to that destination, it can do so differently, if it wishes to advertise South Africa then buy the news spot on Sky or CNN or BBC and put a nice advertorial feature about South African tourist destinations, Kruger national park, Cape Town and so on and so forth, if that's what it's mission is, but it's not going to achieve any objective by having the tail standing at Beijing airport all day long, and don't forget Beijing is merely 1 point, what about all of the other points? Shanghai, Guangzhou, etc. there are lots of other points that it needs to get access to South Africans and for those markets to get access to South Africa. It's not going to do it holistically via Beijing, so it has got to stop the vanity parade and get more in tune with the reality of what the markets require. Strategically I think it does fulfil a role at the moment because it has a comprehensive network system, and that's aside from the Beijing, it does need to bring the markets in and out of Johannesburg, Cape Town, and Durban, but specifically Johannesburg and then to beyond markets, and that's the role we play in concert with them, they do play a role of their own but we also play a role in conjunction with, and that's for me the strategic value BLUE DIAMOND AIR does fulfil a strategic role in that context at the moment, as do we, but I don't see a strategic role that SAX plays because there's nothing now that sax does uniquely, where there is a lot that RegionAir does uniquely, and I'm not pitching RegionAir against SA Express but it's a fact it is a matter of fact.

Do you ever employ consultants to advise your business in terms of globalisation?

We don't need to consult consultants; we find consultants tell you what you tell them. We could confer with consultants and we have done historically we've engaged the likes of Sebree, SH&E, and airline planning group but normally via Blue Diamond air. We obviously try and keep in tune with the developments in the market and we look in all issues including the aero political issues and market related issues, like for example where a big dominant carrier like emirates places orders for 150 airbus 380s and 150 Boeing 777's, we watch that space and we say so now what are they going to do, where are they going to develop their network system to and from, and how and with what equipment, and what impact is that going to have on us, and I'm just giving you an example, but we do that, we apply our minds to all of it holistically, and then we watch, we monitor what happens at the local level, at the regional level, and we go and test market opportunities we go and see if the franchise system we operate is acceptable in other domains like Mozambique, in Madagascar, in Zimbabwe and Zambia wherever, because in the end we got to think about how within the constraints, we can carry on developing our business so that it permeates the whole of the sub region if we possibly can and beyond, and that's really what our mission is you got to live within your environment, you can't change the environment necessarily, it is what it is. So you got to work within that environment, and thats what we try and do. All airlines need to be astute in that way, but you know those that don't have the capacity and capability will rely on consultants, and consultants i think do fulfil a role, but from our perspective we don't necessarily prefer working with consultants, we prefer designing and developing our destiny ourselves.

INTERVIEW ENDS

9.4.2. Transcript 2: Interview with head of commercial at a European based airline

In terms of ownership regulations and the so called air freedom points, airlines operate in a well defined regulatory environment, are the regulations enabling or onerous of airlines?

I think if you look at the airline industry and how it's developed, I was at the business traveller awards on Tuesday and we were talking quite extensively about this boom and bust cycle within aviation. Put quite frankly there has been too many airlines in the market which have not been able to offer the wider industry a sustainable return on investment, because there's too many competitors, too much capacity, pricing and yield are therefore only going to be able to get to a certain level, with the amount of carriers in the market. What you see certainly of late there is a trend towards consolidation, and British Airways is one of the prime examples of that as so far as we're know part of the larger CONSORTIUM A grouping, so we got Iberia as well as the low cost carrier as well. Now in terms of ownership, I don't know the exact percentages but there is different regulatory requirements within each country which basically prohibit foreign ownership. Therefore in terms of what that means for the industry I do think that it's quite onerous in so far as foreign airlines can't take a controlling stake in airlines that perhaps do need the assistance. Qantas is a perfect case in point in terms of 49% I think is the threshold I don't know the exact figure but Qantas is calling out for direct foreign investment. I'm not saying necessarily saying I agree with that but certainly something that I think if there was a more liberal approach then we wouldn't see as many failing airlines, we would see a move towards consolidation, see better return on investments in the airline industry, and hopefully that in turn would hopefully improve the consumer proposition, because you will get long-term sustainable strategic investment decisions being made, and being backed by successful airlines whereas at the moment we're getting because we are allowing that the liberalisation in the market deregulation was seeing a lot of government having to stepping in and back their flag carriers South Africa is a case in point, Italy is a case in point and there is numerous other examples of where the state is having to step in because of this onerous regulation which is not liberalised and I think if you look at a lot of other industries there is not this need for a cap but for some reason there seems to be ceiling as it were, in relation to aviation maybe it is the sensitivities around national carriers, having to have that uplift from your nation to be able to sustain economic activity that might be some of the reasoning behind but that is a long answer to your question.

We spoke of consumer welfare being improved, should these onerous regulations be dropped, do you think the industry when consolidated would be a better, stronger industry?

So I used to be based in the USA and I think the US is a case in point of where they have had this boom and bust, quite frankly the worst thing for consumers is now goes bust, you lose everything don't get the you don't get the uplift, you don’t get the service, you don't get economic benefit’s so from my point of view first and foremost it's for the consumer right and proper that they have an industry that is sustainable that’s there for the long haul, you know is there and able to offer the services they require. Okay with consolidation potentially there does come price increases, naturally because there is less competition but I think you can go the other way as I say where there is too much competition and in having too much competition prices hit rock bottom and there is this race to the bottom which in any other industry that is not workable. So consolidation naturally does mean price increases but price increases mean a sustainable industry, I'm not actually sure that does naturally mean price increases, I think it just me sustainability, and with sustainability you get improved newer aircraft, you get better customer proposition American Airlines are our joint-venture partner for instance now joined with US Airways, you get the economies of scale, you get the ability for a lot of the hubs that have already been established to get new feed to then promulgate the benefit’s that much more, so a regional or smaller airport can actually therefore benefit from the larger machine that the consolidation naturally provides. So in my view consolidation can only be a good thing and in other industries it’s work well. The car industry case in point, the energy industry in the UK certainly and within Europe there is only a certain amount of room for a certain number of players and we have to get to this happy balance point, where we look after our customers we respect our customers we offer a competitive environment, but at the same time we need to have a sustainable industry that can make return on investment can reinvest return and therefore this virtuous cycle I guess continues and everyone's happy hopefully.

If you had a magic wand and you could change the ownership regulations, say the percentages we spoke of earlier, do you think they should be relaxed completely to allow 100% foreign ownership is allowed, do you think checks and balances should be in place to avoid the race to the bottom from too many carriers, how do you do this if you a regulator?

Yeah that's a difficult one, there could be a danger that with 100 percent foreign ownership, then actually you could move right to the extreme, there's extremes to this, with 100% foreign ownership you could potentially see an Emirates of the world takeover say an Italian airline and actually decisions then potentially get made on the basis of profit, and are made from the point of view of say the owner with 100% stake and not in the interest maybe of the wider economic benefits of that state or country, so there probably is a need for some sort of check and benefit's some sort of..... The Premiership football league in the UK has a lot of foreign owners there now, and I think they have a board or panel, and I'm not sure how successful that works in terms of actually these people need to be vetted before they take ownership of the football club, and I think there's been a few football clubs that have suffered because it's been treated as a toy by the new owner and they have done what they wanted. I think there is a danger that could be replicated in the airline industry if you don't get the right people, the right decisions, and I guess again it's happy balance between making sure obviously it's a sustainable industry, but that the consumer and the state or the country or the wider economic benefits are still being preserved, so there is probably a need for some sort checks and balances but at the same time, I think the situation we're in at the moment is preventing real growth and is preventing the real benefits from happening anyway so I think there is a need to relax, but we don't want to go wholesale right the other way either.

So in summary we saying perhaps the ownership isn't the issue, but how the airline is locally relevant in it's local operating environment?

Absolutely! I think it would be a sad story if airlines were being taken over and then were being I don't know whether they then just took the assets, redistributed them elsewhere on other routes and I think there has got to be some sort of safety net as it were, to be able to protect local consumers and make sure that the benefit's are being distributed where they need to be distributed.

If tomorrow we relax the ownership, but we put the checks and balances, namely that you can't strip the assets and redistribute, how do you think airlines would respond. How would you respond?

So me specifically... I'd be I'm pretty excited about it I think and I think particularly speaking about you know the sort of model of the company I'm in whereby you have almost a parent company that's making decisions as to where best to invest, that's pretty exciting in so far as now you've got the ability to actually finally look at aviation markets on the benefit's rather than only kind of hand picking where you can actually get yourself involved, so that that would be quite an exciting prospect I think, and at the same time it would offer and allay concerns of our local consumers, local governments etc. etc. and I think the whole industry could potentially benefit, and if I was there in charge it would be quite an exciting prospect to be able to think of how certain companies, certain processes, certain strategic decisions could be shared and the economies of scale that result can actually benefit everyone.

Would the Middle Eastern carriers be excited by such developments?

It depends on the model they operate, Emirates operates a super connector model anyway and the amount of aircraft they have bought it would be debatable as to whether they would actually need additional feeds from other carriers, they going it alone. Etihad is operating a different model whereby they are buying smaller stakes in foreign airlines and therefore they would probably be more appealing to them in so far as they can actually get the scale they want, without actually buying the assets, that say an Emirates has, they have not gone alone and Air Berlin is one so they could certainly up their stakes in airlines that way. That might be an interesting and exciting prospect for them, I think it would largely depend on the model you operate, if you can go it alone and make a success of it alone, and Emirates are starting this week from Rome to New York. Who is to say they can't do any of this arm themselves, again I guess that comes back to regulation in terms of bilateral agreements actually foreign airlines operating in foreign countries to different area's, that is probably a separate debate to actually ownership of a local airline, can actually some of these foreign airlines do the doings anyway sort of thing. I am trying to think of cases where that has happened, where in some respects it's an outside carrier doing a lot it. South Africa might be example with British Airways in some respects, South African don't fly from Cape Town now, we do, we fly out of Johannesburg to the UK and we have got out franchise partner that's operating domestically, and in some respects could a British Airways become the national carrier almost of South Africa, we will probably have to change the name I don't know? Could it be done that way rather than actually buying a stake in say an RegionAir or an SA Express which probably isn't going to be beneficial anyway.

Some of the weak ones you mentioned, the BLUE DIAMOND AIR's, the Qantas, would they fear being bought out if the rules did change?

Not the way Alan Joyce is speaking, yeah and again there is good and bad to this. I'm sure all things being equal they would love to go it alone, and they would love to make a successful stab to being a national Australian carrier, with Australian backing with Australian flare etc. etc., but can see they're crying out for investment, they pressuring the government for investment, and it comes back to a fight for survival, your priorities change if you are struggling and therefore, I don't think they would be overly concerned because they need the cash and the liquidity and the backing to survive and so it's all I guess relative, it's all perspective, for all those airlines that are eminently successful, or have been reasonably successful would they appreciate being taken over by foreign airline probably not. I think in the public's mind as well that's quite difficult to grasp, but equally I think the Australian public are probably more concerned about whether they have a carrier that's going to be able to give them the lift to the places that they need to be so I think it comes down to a matter of perspective at certain times.

Emirates are doing some interesting things in Zimbabwe, Zambia, Malawi. The public there seemed to have embraced the access there, do you think that's a normal reaction, or is that unique to Africa, where in the past they have been poorly served?

Again this is matter of perspective isn’t it? If don't have a successful national carrier and you starting from a low base in terms of you don't have anything whatsoever and you can see the bright lights of Emirates offering you substantial feed and connector feed via Dubai you would be more than happy, but again in the UK where we have established carriers for yonks’, A) it’s not going to make much of a difference because you already got the facilities there anyway and B) There is an inertia I guess towards what was familiar, what happened before, so that's not to say Emirates has done very well in the UK, but it is easier having the effect that say a Zimbabwe or Malawi has had, because this is successful big airline coming in and offering what I think will be sustainable successful long-term feed, where again they have probably been used to a national carrier that for a couple of years has done okay but has not given them nowhere near what they need to a benefit themselves for the wider economy

You spoke a moment ago about the operation of the route, and your franchise locally, that has given you access to our market, could a lot of the desire to buy foreign carriers be driven more by the access to the routes, rather than profit’s, or the asset base?

Yeah, slot access is incredibly low and incredibly valuable, the Heathrow, New York route case in point, I don't think it's any secret that we bought BMI because it is a profitable airline, it wasn't profitable, we bought BMI because the slots. The slots that are available at London Heathrow, are incredibly valuable because that's our hub and that's where we can then offer really valuable services from the UK to destinations that the public want us to serve. I think there is a case there it's not always about the airline per se it's about sometimes the assets and the access to this the routes, that you get as a result.

If we have to flip it, let’s park the ownership regulations and imagine they stay as is, but we allow access to any markets, by getting rid of the air freedoms, how does that change things, does the desire for liberalised ownership remain, or does that mean instead of being based out of Heathrow, being able to have a hub abroad.

This comes back to what I was saying in terms of Emirates actually, another way to square this circle is do you liberalise all the agreements to actually open up competition much more significantly to say let's, which they have done allow Emirates to operate a Rome to New York, does that become the future in terms of allowing foreign airlines to compete on local routes, and that might be, I think if you do that, then there I see no need to take over another airline, you might do that naturally to as other companies do to get the benefit's from from an asset perspective, per se planes etc. You might do it for some brand elements or something along those lines but the crux of the issue is around access, and plying the routes the want to ply so if say you can do that and do your own thing with your own brand, providing that brands has relative traction and support within that country there is I guess is no reason why you wouldn't do it that way

That brings an interesting question, is ownership or access to routes more critical?

I think it's access to routes in that regard, because you can own an airline and not fly anywhere, or fly 2-3 places which are not of benefit to anyone and then there's no point necessarily in buying that airline, as you say the motivating factor or the driver for these airlines for any airline is flying routes that consumers want to fly that they know are profitable and that they can sustain and make work. There's a reason why airlines have network development departments they don't have ownership departments as such do they, so decisions strategically are taken at a route based level I would suggest

Speaking routes, is it a case of having easier access to markets, or would it be more beneficial having sub hubs in various destinations? Alternatively would you want to fly sectors that include flights that don't touch your current hub?

So you suggest BA operates a Shanghai Joburg if the regulation allowed? I'm sure, we getting into routes and access etc. but then it has got to be commercially viable. So it's very difficult for a UK-based carrier or a South African-based carrier to then set up a hub in a totally different country with totally different rules and regs aside from aviation, with then a requirement to obviously employ local people, currency and banking, all those sorts of things, so whilst liberalisation and deregulation may help in terms of certain routes serving premier stellar top 10 top 20 routes potentially, in terms of foreign airlines could operate those and potentially make them successful I think a lot of these other routes, whilst you would see the deregulation you wouldn't have the appetite from the airlines commercially, because of the constraints, because of the risks, because of the setup cost that is required to make that work, and whilst that access is important I don't think on a Shanghai to Joburg for instance, that a British Airways Brand versus a South African brand or a Chinese brand is going to fair so successfully. So it would be great the airline has the access, but it's then got to be commercially viable, and then that does turn full circle in terms of whether does ownership become more important, I don't know. But my view would be, you have got to have the mechanics there and then you can potentially change your brand, make it work for you, adapt to the market, adapt to the conditions but I think a lot of these routes potentially wouldn't be commercially viable anyway, for these airlines if they did enter those markets to make them work, and that's why you see so many airlines hubbed centrally around certain key flows, certain key cities because they know commercially they work

For a moment if we forget about the current industry, if we had to start over tomorrow, would it make sense to have a global brand, so like the camera business has Canon and Nikon, is there perhaps place in the world for a global airline brand, that's not British, you remove the regional aspect out. Are there economies of scale in operating multiple hubs multiple routes under one brand.

I was going to say you have that in Emirates, it's debatable as to whether they do have true hubs outside of Dubai, but they certainly made a good go of it in terms of being a global airline brand, and let's be honest, the point-to-point traffic to Dubai I think is pretty minimal, not many people necessarily want to go to Dubai, but they made Dubai a super connector and it allowed them to operate globally too many many different destinations. In some respects they have been achieved a global airline status, I think from a European side of things it's mainly been a bit more piecemeal it's been a bit more based on national borders, national territories, national flag carriers, so in some respects the European carriers haven't been as successful at doing that, but we sort of talking about a utopia in terms of global airlines, and I don't know how much room there would be for more than three or something like that, three is a stab in the dark. Does that work for the world today in a way with the complexity with the way in which consumers operate, with where they want to operate and could a global airline get that nuanced customer requirement down to a T? They would have to operate short haul, long haul, mid haul hubbing in a variety of different countries, offer a variety of different things, to a variety of different customers, and I think there's only so far you can take that. I think therefore you always going to have potentially an industry that does ..... today I think we still not in steady-state final stay and I think there is room for further consolidation and groupings, I think to see two or three global carriers is potentially not the way it develops, maybe you have 3 big groupings, and then I don't know maybe a number of carriers underneath, but whether it was just a number of carriers per se, I don't know?

We speak of groupings, are we talking Oneworld, Star, Skyteam? We have that already

Yes, and that have been a bit slow to start as well, and I think potentially and not to blow our own trumpet but actually the CONSORTIUM A model is probably a very interesting one, and has really caught the market's attention in terms of you have a non-descript brand, let's look at the consumer space a Unilever, a P&G and you have a number of multibrand's that pertain an offer something to the local markets that is recognisable but operate together and offer economies of scale, that allow them to cooperate, reduce costs but also improve revenue but at the same time remain relevant and I think that actually is is is quite interesting model for how this might work.

So perhaps the alliances haven't been as successful as they could because each business within has stayed totally independent there hasn't been that collaboration, bar routes.

Yeah within alliances you come back to regulation again, you aren't able to have that ability to cooperate and work together, so it is great that people can club together on certain things but the strategic value then I guess again has a ceiling so kind of it's grouping part of a club, but if that club can't do what you want it to do then there is only so much value in doing so. I quite like the idea of the CONSORTIUM A model and I think with further deregulation I wouldn't be surprised if an American Airlines would want to join CONSORTIUM A and vice versa and CONSORTIUM A want to work with American Airlines. It's a natural fit, in terms of we got a joint-venture partnership, we don't compete on American domestic routes so why not work more closely together and then again you consolidate, you get the economies of scale, you work to get the revenue etc. and you get these broad groupings I guess which would probably be based to the geographic geographical elements I guess.

Is there room for another CONSORTIUM A or similar?

Yeah absolutely, I think you are getting to the stage where where there are potentially groupings that are starting to form that potentially do look like a group. Potentially Lufthansa group has Swiss, Austrian within that, they have taken a much more top down and Lufthansa has kind of been the..... but I think your seeing within these big groupings that they sort of trying to operate this multi brand model, Air France is doing it as well, with hop is their low-cost carrier, obviously KLM within that group is well, Alitalia, you can see it started to develop. LATAM as well have just joined together, does that become a South American grouping and can they therefore make those sorts of things work, and I think within Africa you you be foolish to suppose that that wouldn't be happening moving forward, I mean South African has a low-cost model and it's operating different brands okay, actually there is a number of different brands isn't there, albeit I don't quite understand how the ownership works, it's a little bit mind-bogglingly, but you have got and nobody has really been able to explain to me, but there is government stakes here and there, RegionAir, you've got Mango, you've got South African and they're all doing different things, but broadly speaking they're all part of the same company aren't they? I think you are seeing that sort of model developed.

What about Asia Pacific region? That's where there is a lot of interest.

Yeah, I think that's not going to be exempt from what's going, and I think you've got various alliances and things going on, China has Southern China, Eastern with Sky Team, Air France paired up all working together, and then we just operate we just started the Siberian joint business now, with Japan airlines and Finnair. These groupings are starting to happen on an intercontinental basis, but on a on a local shall basis as well. There is obviously a number of low-cost carriers that are springing up there is obviously a number of established carriers are having to adapt, you've got quite a number of national carriers in so far as you got Malaysia, Singapore, you've got Cathay all operating in relatively small, Malaysia aside, Singapore and Hong Kong are quite small markets as such. Can they continue to stand-alone in quite niche markets? Don't get me wrong they do very well but I think as we see these moves towards consolidation I have no doubt, deregulation will you continue to happen.. are they going to be able to continue to operate on a stand-alone basis without in some way pairing or strengthening themselves by joining a wider grouping?

So right now the JV's of today and the past....

Ya I think it's the precursor to why the consolidation

And perhaps the 3 global alliances have enabled the direction, is it moving towards a next evolution?

Well if anything you can look at this in a pyramid base way, you got the alliances, quite broad groupings have lots of different airlines, that have kind of worked together and some have fallen by the way side, and you getting a sort of steady state in terms of alliances, how the look and what they feel like. The next stage is okay how do you take that to the next level, let's operate a joint venture so trans-Atlantic, you've got 3 broad groupings, Siberian joint business, and then there's various in South America and Europe it's the natural next step and then I think the CONSORTIUM A model is taking that to the next level well if we operate the joint-venture we might as well actually be part of the same company but that requires deregulations to make that happen and I think the the joint ventures did as well, people relented on that, it's just a natural next step isn't it? Its kind phases in terms of look and feel and then who knows maybe you are right in terms of after CONSORTIUM A, we do then just get three global airlines, I think for me that's a little bit stretched too far, yeah at the moment.

Do you think deregulation is good? Should it continue?

Yes

Instantly or paced?

Yes I think I said paced, there have to be a number of checks and balances to make this work in the right way for people.

If it should happen in the way we have described, do you think the industry will be better off overall, winners and looser or everyone is a winner?

With consolidation there has got to be winners and losers, not everyone comes out as a winner, I think importantly consumers will be winners, and I think the airlines I don't want to say deserve, but the airlines that naturally operate in the most stringent and strategic and successful way will be the winners and that is, I think that's the way the business and industry should operate, there should be competition, there should be market forces operating, and there shouldn't be this protectionism, state backed, or one size fit’s all kind of approach, we should have fair competition, and in having fair competition then the consumer benefit’s, but naturally with competition somebody is going to loose.

Other than operating stringently, what other characteristics would distinguish winners from losers.

So the airline industry no secret you've got to have your cost base under control, there is a high amount of fixed costs which will not be able to necessarily control, you're subject to fluctuations in the oil market, so you got to make you're variable costs are under control. Revenue then is obviously important so you've got to have the right product, alluding back to the destinations you serve, they have got to be relevant, you’ve got to increasingly cater to a number of complex journeys, different destinations and consumers that are wanting more and more, a differentiated experience, an individual experience that is pertinent and relevant to them.

Would the differentiated experience be soft or hard product based?

Both

Is any more important?

Go back to Emirates people are incredibly impressed with the hard product in so far as what you do see on board, I think that can have it's limit's though, it's great being flashy here and there, but if you not getting your drink served or your food served then surly cabin crew then I think you both are equally important, I guess from a first internal, the first initial impression it's probably hard, but when you there sat in your seat you can have all the hard product that you want, it's really about differentiated service and style and making that service work for your customer.

Do you think complete deregulation will ever occur... or in the next 20 years?

So when you say complete deregulation that would allow 100% ownership, it could, so I'll say yes it could but I'm not entirely convinced we will get to 100%, I think you will see a pretty substantial deregulation probably within the next 5 to 10 years. I don't know how long that will last, I think that that will then take a while to maybe kick forward as well.

In our discussion today, you see the angle of my research are there any variables I haven't covered or steered the conversation to, that you would like me to introduce?

No, you have covered most things, and most variables that airlines and governments would be considering.

In formulating a strategy you use models internally, do you guys rely on external consultants?

I am not necessarily privy to all those sort of things you know I'm basically managing the regional commercial elements here, but from a strategic point of view I think there's a lot of internal analysing, dissecting etc but I will be surprised if we werent using external models, be it models that are widely available or bringing people in to assist with that it would naturally makes sense, and I think sometimes it helps to have external point of view anyway.

INTERVIEW ENDS

9.4.3. Transcript 3: Interview with CEO at a South African based airline

My first question is regarding ownership and the so called air freedom points within that the airlines operate in quite a well defined regulatory environment, do you find that these enable airlines or are onerous of airlines'?

The regulations?

Yes

I suppose the regulations are there to keep everybody safe at the end of the day, so they are good but some can be pretty challenging, and you mentioned ownership, which can be restrictive.

In a good way? Does it have pros and cons?

Both sides, there are good sides and there are bad sides to it at the end of the day you want to protect local jobs and keep that dominant international players, but can also have downsides I supposes, particularly if you look at economies, not maybe a strong as what South Africa's is, particularly north of South Africa, in a lot of those countries have nothing but a sort of struggling national carrier which can barely meet any of the requirements of the country actually needs so in those senses it's probably bad.

In terms of the air freedom point and the ownership stance, what do you think is more of a challenge to airlines is it the ownership or the ability to route and fly where you want to fly?

I think from an African point of view probably the routes to be able to fly where you want to fly, I think the fact that the industry is still so regulated by bilaterals is a major restriction or stumbling block.

In your experience to get a route you can't negotiate you own bilateral you rely on the state to do that for you?

That's correct, we don't have any direct experience with it, it's only what you hear in the industry so anything that I say is kind of third party rather than my own personal experience but it is very restrictive and obviously there is a lot of political involvement and again protectionism of national airlines, so it's not always the case of the best airline or the most competitive getting the route, so you look at an open skies arrangement like you have in Europe where anybody could fly any where, it's certainly a lot easier.

Do you think the consumer benefit's?

Absolutely.

In terms of when you wanting to set out, like for instance you are about to, your ownership is controlled even though you only operate within our borders, has that slowed down your roll out, being limited to a maximum of a 25% foreign stake?

No

Would you have wanted more?

It hasn't necessarily slowed us, the process of the objection from Silverair did slow us down, but from a pure business point of view it hasn't, but if you're were a starter I think it would probably slow you down, bearing in mind we have had a a business that has been going for 50 years, so we have a certain amount of capital and resources behind us, but if you're a new guy wanting to start something and you looking to borrow money and looking to set up something then yes it just limit's your scope and where you can get that.

Do you think it could derail the startup, you're an establish business but a startup could be derailed?

Yes, I am sure it will, it could.

When speaking especially within the local environment we have now got a few players that are operating but it's quiet, RegionAir seem to have a niche for themselves, Express too, Silverair and BLUE DIAMOND AIR are operating, your addition to the market how do you see that benefiting where is your niche?

We have positioned ourselves as a true low-cost carrier so rather than if you look at Mango, BLUE DIAMOND AIR, BA, Kulula and Silverair, they both kind of hybrid models, so yes they operate on a sort of low-cost model that they are actually hybrids, more than a pure low-cost, so we trying to position ourselves as a true low-cost to try and stimulate the bottom end of the pyramid of the user and try and basically open up again for people who haven't flown either previously or can no longer afford to fly

We spoke of developing a new sector, what is the effect of the economy having a new layer or a lower base to the pyramid?

Well I don't have all the facts and the figures but everywhere you look in the world aviation and in particular travel is an enabler for economies to grow, so if you can now all of a sudden have an additional whatever the number of passengers we will carry travelling there's certainly an enabling factor to the industry whether it's rental cars, accommodation, whatever it is that flows from that there is certainly is an enabling factor that it creates.

If I could give you the right to be a lawmaker to amend the regulatory environment within you operate what would things be that you would like to change or manipulate, or put together.

I suppose it would be to try and just open up the air space, if we can get to a sort of an open environment within the African region, that would be the first step and that would be really good. In fact it was done back in the late 90s the Yamoussoukro decision was signed it has just never been implemented so if they just implemented that and had an open skies policy in Africa that would be really good.

I asked that question from your point of view would it be more beneficial for an airline to operate regionally rather than within the domestic or is it domestic and regional?

My opinion is both, we need if you just look at the areas north of us from a South African point of view if you have access in this domestic market it does give you a firm footing, but I think the regional markets certainly can be benefit on top of it so combination of the two.

Those that do operate, if you look Gaborone, Maputo they to get a much higher revenue relative to the sector distance, would you still take your low cost model to the region?

I think very much so yes, I think those high fares are only because of the fact that they are so self-control or because of the bilateral agreement, there is only a limited number of services or seats infect on some of the bilaterals so if you only have a limited supply you can have a higher demand and a higher price.

So that's an exact product of the protectionist environment is the higher fare.

I believe so, yes.

If those in power listen to you and say let's open up the bilateral space what would be your response, would you look at what range to implement?

If it was that quick you would immediately be limited to the range of your equipment can operate, but I would imagine sub Saharan would probably be ideal, in North Africa is very well served and is more European than probably African, so sub Saharan would be the ideal areas to focus on.

Are the competitors missing any sub-Saharan spots?

I don’t think so BLUE DIAMOND AIR has a pretty good reach, the BA Silverair brand is slowly growing into some of those as well, SA express has some. So I think they targeting the ones that they can, but again I think the issue becomes because it is regulated there is only a limited number, if there is only five flights allowed on a certain route and all five are taken then where would you go? Whereas if it was a pure open sky situation why would you fly just to Harare or just to Vic falls when you could fly somewhere else where there is maybe more of a demand or more of a need certainly and certainly more opportunities.

A comment has been levelled that where open skies like the EU has happened you get have over capacity initially and there is a race to the bottom.

There may well be.

How does one minimise that effect?

I suppose it depends in my opinion in what happens normally is that the successful airlines will add additional capacity because they know they can obviously make a success of it, I think what falls out of the bottom is the old legacy airlines or in our case probably the state owned airlines, that are unable to compete, and I think that's I don't even think that would eventually kill them if they were just held to normal business principles most of them would've been gone years ago, you have airlines with huge debts with thousands and thousands of people operating 10 flights a day, it's ridiculous.

There is a feeling that not only does protectionism act as a barrier to entry for new carriers but also acts as a barrier to exit for the incumbents.

In what way?

So for instance protectionism, the argument made is the state has to keep BLUE DIAMOND AIR going because if they don't there is no airline to fill the gap.

That’s true, it’s possible.

Essentially are you substituting A for B the difference in then the efficiency. When a new carrier comes in without that protectionism they got to make a business case, what is the leavers that those business managers have to make sure that they don't fall into the trap that the previous parastatal did?

When you look at it from a pure business point of view, the business has sort of natural checks and balances if you not making money you don't succeed, whereas I think from a state owned business the drivers are different it’s about employment it’s about all sorts of things, not just about running a business, it’s about flying the flag, the routes you fly are mostly determined by political rather than business.

That brings up an interesting point, do you think there is a place for a state owned enterprise or a state owned airline a flag carrier?

In some instances maybe, but it depends on how it run, the fact that it's a state-owned enterprise doesn't mean that it has to be a burden on the state, but at the same time if the state wants to dictate where it should fly and how it should fly then it needs to sort of accept the things that go with it, you can’t blame or fire management every time it makes a loss, because they are doing what you asked them to do

On the point of state owned corporations, would you say they have a clearly defined mandate?

It depends on what you ... if you listen to what the media says and you listen to what people say maybe they have a mixed up idea of what's what and that’s part of what’s caused their demise, if you can call it that. The state wants them to be something which is probably not sustainable from a business point of view and management is trying to run a successful business, so there is probably an unclear mandate, in that sense.

If they had to open up the domestic market many people who could operate yourselves as example, but is there certain routings that perhaps private industry can't do, especially the super long hauls? Do you think that the local industry would be more accepted of the state carrier and the bailouts and everything that goes along with, if they were non-competitive to places where private business and is able to sustain?

It would certainly make more sense, yes, I think it clarifies or focuses that statement as you say, they become a flag carrier in a flag presence or national presence on long haul routes, but domestically there not subsidised so the domestic people can operate on a business basis.

And if they operate the domestic routes purely as an enabler to feed into the international routes but do so on a non-competitive basis, at the moment I think a lot of times BLUE DIAMOND AIR tends to drop pricing down to unacceptable levels, if they are to have a base they speak of fare buckets, K class, L Class, etc. if they say we won't go lower than a K and using it purely as a feeder service would the local private airlines be more accepting?

Well I suppose the airlines will probably accept it, but then are you not into a price-fixing kind of situation so what's the consumer say, because then the consumer is effectively funding all of that

The consumer then would have options to fly yourselves, or Silverair?

Sure.

If we can for a moment speak about ownership you've got an airline launching in a month, at some point you will want to grow and expand I would imagine, would you like the ability to speak to a Middle East carrier,

we have an excellent footprint in southern Africa for instance if the bilateral are set aside. A lot of times 25% is not enough for them to be interested, how would you change your business if you could offer them a sale of say 60% or even greater share, would that change your business considerably, or would you want to stay local?

We would prefer to stay local and you want to protect local jobs and depends on how it wants to be done, but if that means that it makes you a lot more, bigger, better within your own marker then it certainly worth looking ATM but I would say as long as it's on the grounds that it doesn't affect the local people, that's our biggest resources and our most critical resource is people so if you want to do something with a new player and all he wants to do his use your rights, than effectively it's not something that is worth considering.

So with terms and conditions, people, not stripping assets, landing rights, how would you feel about brand?

Well our brand is very dear to us, but it depends on where you going with the business and if that gives you a bigger, better, look at how successful Silverair is by flying under the BA brand, then it's great it's probably the best airline brand in the world, so if you can tie that on all of your tails it makes sense.

So you okay with changing regulations but it's not okay from a purely business, there has to be a South African.. what's in the best interest of a SA Proprietary limited so to speak, so local?

There needs to be some local form of protectionism sure, protectionism is a horrible word.

Shifting from the domestic market to the global, from your experience in the industry, it is said if the market has to totally liberalise, you could end up with a few large carriers, they call them the white tails, not owned to a particular country, essentially true globalisation of the industry, I would imagine, actually you can tell me how you feel but that would probably be

a lot more long haul type situation, Emirates is probably doing it right now?

Sure.

In the global aviation industry is that a good thing? Or would you think that rationalising or consolidating to say three to eight of these mega carriers would be bad for the industry?

I agree that it would probably only happen on the long-haul stuff, because domestically it's going to be very difficult to bring a product with all of it's clears idiosyncrasies from another country and try embed it here, it would be difficult not just here, any country. I think long-haul internationally you are going to end up in that position I believe where you end up with 10 or 12 mega carriers that are going to dominate all the different routes, and a lot of them based out of major hubs in the world. Just look at the aircraft, the aircraft are heading that way as well, the A380 is only ever going to be operated by handful of operators flying 10 or 20 city pairs, it's never going to fly everywhere, it will never fly Joburg to Cape Town, so I think the industry is heading that way.

You say hubs, that's a geographical constraint, what can airlines do to position themselves perhaps the big legacy carriers now, perhaps Lufthansa, Qantas is in a lot of trouble, but how do these players make themselves a bigger carrier?

Qantas particularly is going to be very difficult now, as they're an end of line carrier, they not a hub. Qantas will probably see more of it's growth domestically within Australia than outside of Australia that unfortunately the tag on the end of the line. Emirates is very well placed, Lufthansa is more of an issue because they have a hub, they can go East or west, or North and South, so they okay, but Qantas is definitely going to have more of an issue. I think that's why they've change their alliance now to join up more with Emirates, to become part of that, even if it's a service provider but the end of the day they associated

That's a nice segway, they were one of the founding members of Oneworld, and you have the three alliances right now, which people say is that start of a mega carrier, but within those, each business is it's own island, with Qantas now straddling between Oneworld, and Emirates, do the alliances have enough momentum to actually form these mega companies, if the regulations were to relax?

I don't know, I have never dealt with them in those kind of details, but I would imagine that you are again jurisdictions and regional differences will probably make it very difficult, but at the same time I always thought that the Airfrance KLM merger would never go anywhere, and it seems to be very successful so I don't know.

The other one would be the BA Iberia link?

Sure, seems to be working so yes it's possible

Is that perhaps the next iteration of the Alliance are these pairing and perhaps American Airlines joining CONSORTIUM A? That could be the next .....

So it becomes more than just a codeshare or an alliance it becomes more a sort of equity control.

So JV to Alliance and then equity. Do you think that will lead to better utilisation of assets and ultimately better consumer welfare?

Incrementally, from an airline point of view open some of the synergies from a bulk buying point of view, I am not so sure about synergies with operations, because it still be difficult to move aircraft across jurisdictions but you would certainly get benefit's from acquisitions, if you're buying 200 737's versus each one buying 20 or 50 of their own, certain benefit's to that, and the I suppose it makes the whole funnelling of passengers more formal rather than just a code share, let's try and work together.

So bulk buying and synchronisation of operations?

Sure, synergies.

Rewinding a little we spoke geography and said Qantas is end of the line, could they make themselves a mega carrier or is it simply that because they end of the line there is now way? If that's the case is there an argument to be made that the Middle Eastern carriers are the future of long-haul simply because of geography, and if so is there another place on earth that could end up as another half way stop? Maybe the Pacific Islands, between North America South America, and Asia Australasia, where the Middle East carriers cannot reach? Are there other gaps, or has the Middle East won?

I wouldn't say the won, I mean look at Changi and Singapore, have been doing what Emirates is doing for a lot longer, just not on the same scale, and off the centre line if you can call it that. Whereas Emirates is close to the middle.

You said the middle line, does Africa hold opportunities like that, Southern Africa is probably isolated a bit? Ethiopia Addis, come to mind.

Kenya comes to mind but I think Africa has challenges of it's own. Our travelling population is less than other areas for sure, and I think it brings other issues; security issues, connectivity all those kind of things, would make Africa a challenge to be a major hub, there is no carriers that are capable of that right now within africa, short of letting somebody in from outside come and do it.

If they can pull it off would it have economic benefit's or is it just that they become a gateway?

Well I think if you can set yourself up as a hub it certainly is a economic benefit look at what Changi did for Singapore it's a huge economic benefit, so it certainly could help but i think it's about the will and trying to make it all happen

So there is a carrot if they can?

Ya, sure

In an open skies arrangement globally what are the things holding airlines back, and what would they do tomorrow if they could get it? European airspace within the EU specifically, if you had to go cross continental what are the big players waiting for and what would they do?

Well as much as there is open skies within Europe it is still only for European carriers, and it's the same in the US, the US is the most protected market in the world, so nobody is allowed to go operate there, although they want to operate everywhere else, it will probably be very difficult to just go transplant a BA into the US market, it's tough you need to know the differences, how it works and all those kind of things, it could probably open up more cooperation probably to start made, may end up at the end of the day with equity type arrangements but it would certainly allow greater co-operation between carriers in different markets.

So the likes of a BA cannot transport itselfinto the US? Two issues, BA is just an organ of the CONSORTIUM A group, what if the CONSORTIUM A group, went into America with a new non descript tail that not location bound? The British gets taken out of British Airways, could the airline become a corporation game, going where they need to go?

Sure,

If the regulations allowed.

You could but to go and start from scratch is usually expensively, very time-consuming issue, if you just look at how long Virgin to get settled in the US, I mean that took years so it is not something you can just walk in and say you want to do this now and tomorrow we will have a licence and we will start operating, it's a very complex...

So more than the ability to be based in the country, and places to places to fly in terms of allowed routings, what are the other things? Brand....

Ya, there is a whole brand, and a trust in that brand, the regulatory issues of applying for a licence, applying for an AOC, the right people, the right everything else that goes with it.

How has your experience been locally, the reception to your new brand?

I think we've had a pretty good reception, I think people were pretty positive towards it, but again we haven't been around, we been around a little bit longer than just a new start up, but even for us and it is proving to be, it takes a while you go have got to go out there and prove yourself.

What are the positives and negatives that you have experienced now? What feedback are you getting?

I think there's a lot of people that have dealt with us in the past, so that was positive, that has helped us, going forward there is also quite a lot of resentment, people I think are upset with what happened in the market over the last two years, pricing wise etc. so that also helped, because you kind of the new kid on the block, so it’s support just because we are different rather than because they know anything about us, so I think that's one of the good positive things. Negative side I think it's just a huge challenge to go out there and launch a whole new consumer brand and particularly when you competing with the likes of Silverair who have the British Airways muscle and everything else behind them, BLUE DIAMOND AIR that have been here for seventy years, they big well-established so it’s going to take a while.

How does the 1time, Velvet, Sunair ... all those failures negative affect...

There is still a lot of negative perception out there, the fly by nights we are not going to be around. 1time low-cost airlines don't work in South Africa, look what happened to Velvet and 1time etc. so there is quite a bit of negative perception. We certainly underestimated the amount of that, and I think how much the public got hurt, I think the public got hurt a lot with all those nationwide's 1times everybody else.

Are you carrying their battle scars?

Ya we are, and we see good take-up from the start, we have had some good support from when we launched, but i think the real support will come through once we actually start to fly, a lot of people are saying well prove what you can do, and then we will support it.

Your business is very different to 1time for instance, that were operating old aircraft, you operating 737-400's?

Ya

How do you communicate with a consumer that's perhaps is not educated in the nuances of your business, that your business is different. I don't know if you own or lease, how do you tell them "we're sustainable"?

It's a challenge and that is where your media and your PR become so important because they are the ones that need to communicate that message so again it's about advertising, it's about PR, talking to the media and all those kind of things, and then obviously it's going to be about the performance of the operation that you have a good on time reliable operation very important.

Do you think it's important to service routes other than the Joburg Cape Town route?

Absolutely, as long as they make sense financially you have to.

It's not a distraction, in other words have the one focus, shuffling perhaps two planes in a cycle between cities is probably easier than bringing in a flight that's now Durban later P.E. and then later Cape Town?

Maybe, but you lose some of your efficiencies as well by just running the one sector, unfortunately Joburg-Cape Town-Joburg is just too long that you can actually get great utilisation out of your assets and crew, so if you just fly

Joburg-Cape Town you end up using almost double the amount of crew you would do if you flew Joburg Cape Town and then Cape Town PE and back. You can do that all with one crew, you need two crews to do Joburg Cape Town and back every day. So there's some efficiency benefit's that you need to take into account, but it also creates other issues as well it gives you the ability to look at different legs, South Africa covers all those points so we have to cover them. We are not like Europe with hundreds of alternative airfields, one of Ryanairs biggest successes is they can go to any host of Airfields, any one of the major European cities will probably have five or six airfields dotted around with in her 50km radius of it, where as we have a handful, we only have nine airports that is what we have, so you need to be able to service those, not all necessarily but at least some of them

Operating out of the other smaller airfields, it is a critical to be based at OR Tambo as initially you going to be attracting a local domestic consumer, how important is to be based at Joburg international, like Kulula, Mango is doing the Lanseria?

It depends on the mix of your passengers, if your traffic if you relying a lot on interconnecting passengers, or being a feeder for one of the international carriers there is no other option you have to be here, we still see it as a good place to be and would like to set our second wave so we will have our first wave out of Cape Town, the second will be out of Johannesburg and then we will link all the dots together, so it is very important.

What about the even smaller airports, for instance Rand airport wont be on anyone's radar because of the connectivity?

Not just that, I think it's more actually about the airfield, the airfields can't just handle the higher gauge airplanes, and if you want to run like us a low-cost model, you need the volumes of seats to try and run a low-cost model on a 60 seat or something some people may be able to, but I havent worked that out yet so.

But RegionAir does well?

Yes, but they not a low-cost model they more a traditional model and there are very good service, they are very good at what they do with a great operator but it's certainly not a low-cost model where you can, you know a Ryanair model is based on the lowest cost seats and you need to just create the volume, so those airfields unfortunately are not capable of that.

Do you think deregulation should occur?

Regionally?

In the industry.

Well in South Africa it has, and it has worked pretty we have seen the benefit of it, if we look at how many people were travelling in South Africa 30 years ago versus how many travel now, I think it certainly had a big benefit. I think Europe has also seen that so it certainly does make sense.

Would you say South Africa is deregulated? Considering the ownership...

Domestically yes I would say so, the protectionism from an ownership point of view could maybe be reviewed but it's a number is it Europe where it's 51%, here it's 25% foreign owned so it depends.

If it were to be 100% foreign owned?

I would say you could lose, I just have strong feelings about the needs to be some local ownership, particularly to protect your local jobs and your local flair.

With the the move towards full regulation, is the industry and not the consumer welfare but the actual players in the industry are they better off?

To deregulate... full deregulation?

Yes

I would say that's probably a mixed .... some would say, the pure commercial privately driven airlines I would say yes they would be better off the state-owned, or state subsidised would probably be worse off.

So there are winners and losers?

Yes.

The state owned? Largely linked to efficiency?

Yes

What are the efficiencies you need in an airline? Rapid decisions? Aircraft?

It's a complex industry and it's combination of all those things, it probably starts just looking at our own state owned airline, it's a long-term business you need long-term management and long-term visions you can't have very short-term management structures in a long-term business, and I think that's probably my personal opinion the biggest thing that they've been up against they generate a turnaround plan with the team that is committed to make it work, and then they change the management six months later and generate a new plan. In the meantime got assets that have a 30 year life that you need to order five years in advance, if you keep missing all those steps than just becomes hugely inefficient. You left with things because they are there it's not because they're the right things for the business, so that's one of the things and then yes efficiencies, it's about having the right number of people to do the right number of things rather than creating employment.

In undergoing this research process, it has been said the ability to make decisions rapidly is incredibly important and you are introducing the long-term vision. It's about a wide vision or general direction, but making swift

decision rapidly, that leads to bureaucracy do you think bureaucracy is a big problem at the non-efficient carriers?

Sure,

In the next 20 years what are the chances of deregulation happening? It started in the seventies and it's been gradual since, does it have an end point without regulation or will there always be some?

My personal opinion I think Africa will probably not deregulate the way the local industry would like it to deregulate but i think as part of that we probably selling our souls to the Middle East, because the Middle East is just busy, while not just the Middle East, the European and Middle Eastern carriers are basically just eating up Africa. I mean they make more money, carry more traffic, carry more people than any other local airline and it just keeps happening, and just gets more and more.

The Middle East carriers specifically Emirates have done some interesting stuff in Malawi, Zambia and Zimbabwe do you think, that's an argument against Yamoussoukro, do you think that the deregulation that has occurred has benefited foreigners more than local Africans?

Absolutely, you must just caveat locals, locals been Africans rather just Malawians for example.

It's been at our own expense?

Yes absolutely, had they opened up and let's say open skies between the whole sub Saharan Africa, you probably will end up again with a number of strong carriers but at least it would be African-based carriers, whereas at the moment it's easier to go from Zambia to Malawi by going via Dubai with Emirates because they the only ones with regular daily frequency so which is giving it all away.

Is there a fear in Africa that if they had that freedom, even just South of the equator that South African takes a big brother role?

I think there is a certain amount of that and I think that is a fear that some of the local strong carriers like an Ethiopian or Kenyan or BLUE DIAMOND AIR would dominate, but I think there would be a fair balance with commercial carriers as well.

To summarise, we said deregulation is probably not going to occur fully within Africa, I want to continue with will things become more relaxed in the way they interpreted from this point or it is as relaxed as it will ever become?

I suppose it may still get a little bit more, the bilaterals may slowly become more available, but it probably may get a bit better.

That is something you'd want?

Ya, sure.

In chatting today I am sure you see the angle I'm looking at, the constraints on a complex industry and at the same time you haven't got total control because you operating in a very confined space. Are there§ other variables that you deal with, that you've dealt with that I haven't introduced today that you'd like to introduce, perhaps carriers or examples.

Nothing I can think of off hand, we new to scheduled operations, it's a whole new ball game for us. I'd also maybe the regulator, a good strong regulator. our regulator is pretty weak, that allows for, for instance our whole issue from last year would have been probably ended up in a totally different light, if we had a strong regulator so I think that would help.

CAA?

CAA to a limited extent, but more I would say department of transport, licensing.

Do you deal with the external consultants?

We have used.

In terms of?

The low-cost strategy, for the low-cost airlines we have yes.

What were the shortcomings and successes of those dealings?

I think it was largely positive, cause they were low-cost specialists, they it brought a wealth of good information, that I could infer with it, but obviously very skewed to the own previous experience, so the local market knowledge was lacking.

Foreign based?

Ya, foreign based but other than that, I think that it was positive.

If you had to invite them back again what would you tell them that you learned that they didn't know starting out, that you learned through the process.

I think they learned a lot just being here as well. No I suppose it is a different market, it's not the same as Europe, I think the fact that we have limited numbers of airports, that's one of the big things in particular just talking about the low-cost model. The fact all of our airports are so regulated and state-controlled and the fact that this is actually no incentive for the airport to do a deal with an airline which you get in Europe because they're all at the end of the day want to make as much money as possible not attract feet which is the difference in Europe, suppose that would probably be the two main items.

INTERVIEW ENDS

9.4.4. Transcript 4: Interview with CSO at a South African based airline

First question is regarding the air freedom points and the ownership regulations. Do you think these are onerous or enabling of airlines?

You talking about the bilateral framework?

Correct.

Well about half the worlds capacity is now open market, in fact a bit more than half. mostly in US, North America, EU and Eu to North America. But other markets like ASEAN are coming on in a few months. I think there is a trend overall for liberalisation the problem is 10 years ago when this was first pushed really hard the view was there would be liberalization to be somehow even but the fact is it has proven to be quite uneven. Africa is a good case so there is the Yamoussoukro decision way back and that was where African states opened their markets to each other. Now what has happened since Yamoussoukro, has been African states have not opened their markets to each other, they have been very busy opening their markets to non-African states, so there is a form of aviation colonialism has descended on Africa and that's through a few sources one is French state influence the Francophone states so Air France consult very active, they help start, it just been announced the going to help the DRC start an airline. They typically help you start an airline, the first destination has to be Charles de Gaulle so you have to have a wide body aircraft, typically you get one or two aircraft and the airline just falls apart in a couple of years. And that's a way of keeping you dumbed down with the perception that you are being helped by your former colonial master. Also the independence agreements of the colonial states gives the French government first crack at it, that is embedded in the constitution of these states, that is an African example. Or you may even find the opening up to non African states so the really big players in Africa are BLUE DIAMOND AIR Kenya Airways Ethiopian emirates and Turkish Airlines so otherwise you've got these anti trust JVs opening markets between Japan and North America so the respective commercial partners of ANA and JAL have got their respective ATJV's are European airlines are now looking at how they do ATJV's in Asia, so Lufthansa are now looking for a partner in China and this is diluting the value of alliance membership to airlines. So a lot of the market is opening but it's very uneven so ASEAN open skies looks very good on paper but half population of the member states is in Indonesia. Indonesia has decided not to be signed to the open skies agreement. Philippines is about to sign, Philippines is in a big stage of how do we fix our aviation market once and for all, in fact they were down here last week to do a bilateral negotiation, they have just done a bilateral with Oman, with one other state. Some of these states have seen the writing on the wall and are doing a lot, and some of them are just sitting there dumb and stupid. And the consequences of being in the part of the market that's not liberalized, I don't think that's really understood yet, I'm still trying to get my mind around it Certainly it's to your commercial disadvantage I know that straight away but the long-term strategic affect of you not being in the part of the market that is not liberalized or if you are outside of the ATIJV tent. I expect the impact is not good that's all I can say. But overall there is a there has been a broad trend to liberalization however there are some analysts now looking at it saying the actual trend is starting to go back the other way, it starting to be tightened up again. Some markets have been opened far to quickly India, Australia, South African and typically open first to Middle Eastern airlines they use tourism authorities as their cheerleaders as they want airlift, tourism then work with nearly transport department and if they need reinforcements they ask for trade and industry type outfit. So they get around the influence of the National carries in those states and the objectives of these airlines like emirates is to become your national airline so I have been trying to work with various levels of government here for the last few years and whilst everybody nods their head, so for instance they just approved a forth daily frequency to Johannesburg for Emirates so now they now have a larger non-African scale into South Africa than we do, so it's almost mission accomplished for emirates they have almost become a national airline of South Africa as they have become the national airline of Australia as they are about to become the national airline of Zambia and Zimbabwe and that their strategy. They have a six freedom hub and they bank traffic rights well ahead of the true origin and destination demand of that hub and it's all onward traffic they bare economies of scale the cost of capital is substantially lower if it has a cost at all, they got geographic advantage the engine airframe combinations, you know if your draw concentric circles out from Dubai every four or five years is another circle so they go from non-stop the last five years from non-stop 65% of the world's population to non-stop 75% of the worlds population and they builder this traffic is all six freedom. So it’s all about their objectives and not our objectives, their objective is the creation of Dubai as a destination and the projection of state power, so liberalization has had a lot of unintended consequences. So liberalization story is a challenge, it’s a challenge to us it’s a massive challenge to South Africa because we have an open market, and once you open a market you really can’t close. The other critical link between liberalization and consolidation of the market is not understood here, it’s something I have tried to educate the government on, but when markets are liberalized after a while the ownership and control requirements you know the 51/49 stuff starts to break down there are some very clever ways people have got around it over the years like LAN in South America replicating their hubs up, praying on weak states with no airlines, Peru, Ecuador, Dominican republic, and then there is Air Asia who replicated their hub and model into places like Thailand and Indonesia and now the Philippines tried Japan but pulled out, 51/49 but they basically want a local stooge that does their bidding amd they really have true control. Then Etihad’s model where they replicating it’s multi equity investment. that's become possible because of consolidation so your airlines investing in other airlines because now because the markets open and the restrictions are down and the really smart governments see the writing on the wall now they can't protect a national carrier you have to have cross equity. And if you look at the southern hemisphere as a particular case in point every southern hemisphere Major airline has already done this except us and Argentinas aerolinas no coincidence that we both 100% state owned otherwise LanTam, Air New Zealand, Qantas, through their Jetstar investment and virgin Australia have all done quite material cross equity links and you overlay typically they are used to strengthen commercial ties because commercial ties come first, then when you trust each other and you think you reliable parties then the equity comes so there is this inescapable laws of aviation economics and if you want to hold out and block it you can, but you got to have pretty deep pockets and in our case the South African Government doesn’t have that patience to have those deep pockets now but you still got to make that tough decision so liberalization was sort of esoteric topic 10 years ago, some of the things you thought have come to pass but a lot of unintended consequences like the African states opening to non-African states.

You spoke of Indonesian not signing ASEAN do you see a shift, because you said right now it makes sense to be part of open skies, do they see a shift in the future and that's why they not signing or…

Well it could be because they are slow it could be because their airlines are on quite a good pathway because they are restructuring their aviation market they had a lot of challenges with safety airports they imported a lot of IP to fix their airports and air traffic management those were aid funded projects, then Garuda the national carrier was blacklisted by the EU, then they brought in a top flight CEO, and his done a good job, they got off the blacklist they started to expand, retooled their fleet, they going well. Lion which is a large low cost carrier they going well entering the Australian market soon, entering other markets Garuda has it's own low cost subsidiary, so they actually getting their house in order if I was them, I would just sort of wait a year so it could just be that, but it's half the population of the ASEAN states. Then Brunei Dar es Salaam is a small state in ASEAN and they have a state owned airline, but it's funded by the Sultan and I saw a briefing two weeks ago and whilst the sultan says he doesn't have an appetite to fund this thing forever they are busy fixing the airline and it's in quite decent shape. The impact of liberalization on it you won't know for five years so it takes a long time for the effects of liberalization to come through the market, and then airlines think okay the markets open and after a year or two they started thinking what else can we do? Let's have an ATIJV, let's go over and buy 20% of that airline, it takes a while because everybody is a bit busy it does change.

You spoke of Japan how does Africa and Japan fit together, Ethiopian is now flying to Narita from September sometime?

I don't think there are any real similarities between Japan and South Africa. Historic japan there is similarity because we are developmental state policy here and interventional economics it's like post world war 2 japan otherwise it's one of the most mature markets in the world, it's got massive scale, the market doesn't bare any relationship to the markets here. Low-cost traffic, low-cost participants, credible ones have only just come to Japan so they control their airports very tightly so they about five years ago changed their airport policy so they had tiers 1- 4 airports. Tier 1 airports can't have low cost traffic, tier 2 and

3 cans etc. and that's a form of protection of the hub and states that complete delude themselves thinking the market should be opened, it's just not happening anywhere else in the world, Australia made that mistake, it's a bit like free trade agreements, let's open everything because everyone else is just not true, so there are all sorts of examples of protectionist behaviours with airlines just around Africa. Egyptian government doesn't allow low-cost traffic into Cairo, so you got to go to Sham Al Sheik or Luxor, but you can't have it to Cairo. Middle Saudi Arabian airlines much lower price of fuel than any other airline there some of the ownership and control restrictions so you might have a policy where you can have 49% investment in local airlines yet the government will never allow it, because of some policy and there have probably been three changes of government since who ever put the policy in place. Some of the states are quite intent on establishing a national carrier Nigeria, DRC, Ghana, and these are for different reasons, Ghana has a national carrier that failed, Air Ghana international, DRC just Air France consulting, telling them they should start an airline, so they think it's a good idea to start an airline, chance of success 5%. Nigerians want to start a national airline, because their others have failed, their only major carrier ARIK has a whole raft of bilaterals between Nigeria and non-African states, Arik operate one to JFK, otherwise they don't operate any of the others, otherwise they running around West Africa trying to start an airline for Côte d'Ivoire and the assets management company in Nigeria which is a state investment corporation they have had to debt for equity swaps in every major Nigerian airline as they have all failed or approached insolvency, Arik included so some of these up to 40-60% where AMCOM owns the actual airline. The state has all the exposure to these airlines yet cannot control them so Arik stop running around West Africa we want you to fly to Frankfurt and we want you to fly to China and they wont do it, so you got all the exposure and none of the controls so they sick of it and they want to start no matter how stupid you think it may be they want to start their own national carrier. And as it happens they got some quite good advise and if that advice was in china, New Zealand it might work, but I don't think it will work in Nigeria, but they got to do something because at the moment, they got Arik flying in otherwise they got foreign airlines they running tag routes through Abuja, Lagos, port Harcourt. Lufthansa and Emirates are getting all the domestic traffic as well, so there is lots of reasons liberalization is impacting ownership and control but it's got so many unintended consequences.

Do you see the liberalization as being beneficial in the long term?

Overall yes, so if I said it was beneficial to those who think airlines should be state owned? No. Is it beneficial to the consumer? Yes. Is it beneficial to tourism? Yes. Not as beneficial as people think, and SA tourism is no different, the great smoke and mirrors trick with tourism authorities everywhere is they count inbound arrivals, then they take substantial marketing funds, thankfully South Africa tourism doesn't have money, they actually take money and give it to overseas airlines, what's a good example? Dubai, with six flights per day? Thankfully we haven't given them money, we have given them everything else. So your tourism authority go off to a Chinese airline like China Southern and say if you fly daily flights here we will give you 10 million dollar marketing fund, reduced landing charges etc. but they got a state owned airline who doesn't know what's going on. All in the name of what South Africans call airlift, so inbound arrivals go up, which is wonderful, but that airlift is not one way. Let's say Emirates has got four daily flights, they already larger than our scale they already 104% of BLUE DIAMOND AIR, so all this capacity is not only inbound arrivals, yes it is easy to get to South Africa, say I was in Baku wanting to holiday in SA, Kruger park, it's so easy, just 2hr connection in Dubai it doesn't get any easier. For those people coming in getting counted as inbound arrivals at Durban Cape Town and Joburg there's actually seat going out. So maybe I live in PE and I used to take my holiday in Cape Town, now, why got to Cape Town I can go to Latvia, so I go the other way, tourism authorities never account the lost tourism here, so it's a great three card trick.

If we look at the bilaterals and the ownership regulations the 49 51% what do you see as more important in shaping the industry, which has a greater impact on an airlines decisions?

Well I can tell you what drives a good airlines decisions more, they motivated by money, the first thing they got is their brand, key being the safety reputation, really good airlines think brand, unit revenue maximisation, unit cost minimisation, depends on model, full service or low cost, or hybrid. Good airlines are focused on the same things an Anglo American or Siemens or a Walmart focuses on, the numbers. The not so good airlines get distracted by all these other agenda's. Thing is, everyone has an opinion on airlines, even people that never fly, I came here 8 years ago to start Mango, we did focus groups all over Soweto, some of these guys could and had flown a flight, and then you get other guys who had never flown. They liked or didn't like an airline based on having seen it fly past and the colours, like cheering on a formula 1 team.. I like Kulula I don't like 1time, I like Mango. Airlines are swayed, everyone has an opinion, everyone's constantly "you're airline should do this, your airline should do that", we get criticism here, we should be doing more in Africa, until recently we didn't handle our messaging well. We already operate to half the African Union member states, we state owned, we get compared with some other state owned entity plucked out of the blue doing a power station up in Uganda, or an aerospace deal in Benin, and they ask "what are you guys doing?" well we already operate to half the African Union member states, they do business in three. Airlines are a business people THINK they understand.... they don't, it's highly complex, capital intensive, lots of levers to pull in the right sequence, at the right time. If you don't know which ones you're pulling, you going to screw something up on another lever in two years' time. People think airlines are simple, but the not so good airlines, what they're focused on is what everyone else thinks they should be doing, that's the short answer, you got extremes, you got those in the middle. We have a dual mandate to support the national development agenda, and be commercially sustainable. We developed a long term turnaround strategy last year, I lead the development of that and then we started from the position, asking what is our mandate of this business, because we had a mandate, but it was confusing, we had objectives but they were broad objectives, like I explained the bad airlines, just a mesh mash of ideas that cropped up over the years, someone said "ahh wont you do that as well, wont you do this as well". So we went from the position, how dare I even go to the government and say "we need to rethink what the purpose of this airline is" to the board being totally supportive of that. We went back we have five strategic objectives, but the two key ones are to support the national development agenda and being commercially sustainable, people say "how can you have a dual mandate?" but there are airlines all over the world that are state owned with that mandate, Etihad, Qatar, Emirates have got that mandate so the good airlines are all focused on what Walmarts top team would be focused on, just a different industry... numbers numbers numbers, hit the numbers.

So you focus on the business, but how do you change the decisions if for instance you could go out and buy other airlines or you could fly any route to suit yourself or alternatively somebody buys into you?

Well if you could fly any route to suit yourself then everybody else could, and that would suggest the market is completely open, but you also got to compare where we have come from and how it was regulated, if you look at and compare aviation to automotive, telco's, some elements of FMCG, brewing, different histories, different places of market liberalisation, different subsequent and consequent rates of consolidation, and even within this industry, passenger consolidation, passenger cooperation is far more tightly controlled then freight, so there is some anomalies just in our market. Bilaterals are different for cargo and passenger, cargo is far more liberalised, so there is different rates of liberalisation and subsequent consolidation between different aviation industries, but also within sectors of the aviation industry. Airports are totally open market, only government policy stops airport privatisation, so there is no international regulation.

Would you say if ownership had to be completely liberalised globally, the resulting effect would be there would be less airlines?

Substantially less airlines, the world has got too many airlines, Africa has 3% of global airline capacity, there is anywhere between 160 and 200 airlines in Africa, 53 AU member states and 3% global capacity, so just in Africa, does Africa have too many airlines? YES, does South America have too many airlines? Probably not, they have just been through a consolidation phase, does Central America have too many airlines, probably does. Does North America have too many airlines, they pretty close to being about right, after a pretty big clean up, and the capacity discipline they have with the chapter 11 protection has got them through. Asia Pacific too many airlines, Europe has taken care of it'self, but probably too many airlines there still. There will certainly be less, it's not just the consolidation that follows, it's the pressure that comes through open markets, Malev the Hungarian airline, state owned, existed purely not on equity injections or bailouts, but straight state subsidies which when Hungary entered the EU were challenged and they lost, and the airline was put into liquidation quickly after that. If the question is 'not just consolidation, because it didnt have a value, so there was a low cost carry there called Whiz, Whiz was sort of going okay, but since Malev has exited, Whizz has gone gangbusters, now they talking about a London stock exchange listing, so low cost carrier operating in a Budapest secondary airport, a bit of a Ryanair, has a state supported carrier around it, now not consolidation involved there, because no one wants to buy it because it has no worth, because you can just come and enter the market, there has got to be something intrinsic that would make you pay anything for it, something intrinsic in EU, is like Sabena and BMi being bought to strip the Heathrow slots out of it, to a competitor in fact, so it is inefficient capacity being allowed to exit the market. So you could argue BLUE DIAMOND AIR is inefficient capacity and should exit the market by now, Air Zimbabwe.

Which market specifically?

The aviation market, totally! Protection prevents the exit of inefficient capacity but so has Avianca, so has Vietnam airlines, so has Fiji Airways, Air Mauritius, so that's the other piece in an open market, inefficient capacity is allowed to exit the market, that's a big thing that's different to just liberalises the market, like a bilateral regime liberalising.

If I could give you a magic wand, you can change either ownership or bilateral regulations, without restriction, what changes would you make?

Probably around liberalisation, because if you fix liberalisation, you fix ownership and control, but it's the unfair and uneven liberalisation.

So you would allow liberalisation, but it would have to be………..?

If I was doing it globally, I'd say it has to be even. There would have to be a view taken, if you liberalise Africa at the same rate as you liberalise Europe. They're better capitalised airlines, they're better run, so some sort of weighting must be allowed... I would say a more cautious, even liberalisation, and it's not so much liberalisation, it's the pace, that's often the killer. For example the Fiji government, they are very busily fixing Air Pacific, now rebranded Air Fiji Airways, they have a new mandate now to develop tourism, which they haven't had for a while, and they have now refleeted, they've rebranded, they've got new top team that's pretty good, and a cornerstone of their strategy is controlled capacity, they not going to open the market, they're not going to be an India, and they not going to be a South Africa. So it's not the fact that your policy is to open the markets and bring further airlines in, it's how quickly you do it. In South Africa it was done too quickly and BLUE DIAMOND AIR hasn't adapted to that competition. In India it's caused the failure of almost every airline there, what happened in India, is they had domestic deregulation like they had here, and everyone rushed out to start airlines, some of them failed, some of them merged, some of them thrived for a while, some of them went international and then failed. So it's different experiences, but it's the pace of liberalisation that's critical, as well as the liberalisation tent.

If we had to focus on pace, how would you pace it, is there a 'right' pace, or is it a case of one size doesn't fit all, you have to consider the market?

It's not a one size fit's all.

What effects the pace, would it be size of market, geographic, maturity?

Existence, size of market, geographic location, proximity to other markets and their sizes, the presence of does that state own an airline or intend to establish one, or intend to protect one, so if you look at Zambia, Zambia had a flag carrier but it was privately owned, and it failed. Zimbabwe had a state owned airline that failed, nobody will admit that, but it did. Then Malawi had a state owned airline, which failed, and they are all right next to one another, so different reactions in three states. The Malawian privatisation commission puts air Malawi up for sale, or sources strategic partner for so much percent, Ethiopian step in, so Air Malawi is not operating, that's one approach. Air Zimbabwe they just stutter around pretending that they are running and they hand Emirates 5th freedom rights, to operate a tag route to Lusaka, a triangle if you like, and that airline sort of continues and there have been a couple of will someone come in and kick the tyres, is there intrinsic value, no don't like it, government will interfere. Then the Zambians they want an airline, their private sector airline failed, there is talk of another airline starting, and they may well do that, but in the mean time they have handed Emirates the same rights the Zimbabweans have. What neither realise is part of Emirates strategy is you run a tag, and then when you mature the market you split the tag, and the same thing happened with Emirates in Nairobi with Addis, they just flew a tag route, when it matured, they split, so I'm sure the Zambians don't realise what the Zimbabweans have done, and the Zimbabweans don't realise what the Zambians have done. But Emirates will use their state to state relations and bilateral service changes, you know when the UAE come calling on a state visit, it's one of five things on their shopping list. 1) We want land to grow rice 2) We willing to invest in electricity infrastructure 3) Oh by the way let's look at the bilateral, so that's the game they play very well, and South Africa plays badly and most African states play badly, but that's how African states have liberalised their markets to non African states. So what are the chances of someone coming along, be it the state or private interests coming along and starting in 3 or 4 years an airline in Zambia or Zimbabwe, you would want to have balls of steal and deep pockets, because Emirates will be so entrenched in there, you have got no international traffic. There three states right next to one another with three different approaches, but they all end with the same outcome because and we contiguous to Zimbabwe, our approach here has been just to open our markets so quickly that no one could cope, if Silverair had international routes, Silverair would be loosing serious money, but Silverair manages their risk, they don't have these long hauls, and Silverair has their relationship with BA that's worth something, but we quite exposed, we should've restructured our business into a better form to compete, but it doesn't matter, we could be the best airline executives in the world, but if you got your government opening the market, you can't win, that's what happened in India.

With hindsight what would you have done differently as BLUE DIAMOND AIR to compete.

1) Far more effective lobbying in Pretoria, the way to defeat it is to improve your business all of the time, you got to question your business model from time to time, we have just done that with our long term turnaround strategy. When I first started discussing as a concept I brought here called a 'whole of state aviation policy framework', when I first started discussing that, I would speak to ministers and DG's and they would ask 'what planet is this guy from, you want me to give something up to those guys?' Like transport, tourism, home affairs,

you kidding! But unfortunately all our major competitors have that framework, all our major state competitors. So where you got transport and tourism policy that's made, you've got a visa regime made through home affairs that structured properly, you've got cognisance that the state owns an airline, like say Fiji, like Singapore.

It's a combined unified approach throughout departments?

Unified approach now all our competitors have that, Ethiopian is probably the best example in the continent, all Middle East states have it, Singapore is a good example, New Zealand is a good example. They make policy with the whole of sector mind set, not "we need more tourists" or "we have got a problem with illegal aliens, let's put a transit visa regime in place", all the transit visa regime has done here has caused quite a material hub displacement from Johannesburg to Nairobi and a bit to Addis. So the home affairs policy of transit visa has supported the growth of Kenyan airlines. If I went and had a grown up conversation in Wellington, they would be totally in tune with what I am saying. Have that conversation here, even if they think, "ahh I know what he is talking about" how would I convince that department to give something up? So it's a political self-interest, we in this band where we have got to support the national development agenda, but the state doesn't support us. One thing we do not need is a bail out, what we need is the right policy to run the business, and that should be the role of the shareholder, and the shareholding vests with the department of public enterprises. Does the business need recapitalisation? Well that's a totally different discussion because when this business was transferred from Transnet to DPE in 2007, Transnet transferred it across totally undercapitalised, I have no idea how they worked out the split of the balance sheets. So we don't need a bail out, why would you give us a bail out, because if you put these policy settings and business model, if you gave us, there is this argument, if you gave us 50 billion how long would it take us to turn it into ten? There is no point in treasury and DPE giving us a bail out if you got transport and tourism and home affairs and even DTi working against us. You know the DTI has NIP, the national industrialisation program, so because we state owned when we buy a 737-800 we pay around 5 - 7% more than Silverair does, because we have to pay into this fund, well technically the OEM pays into the fun, but they transfer that cost into the price. So our cost to fleet is automatically higher than the private sector competitor. Now you never see a comment in the media saying "oh I think that's a complete outrage" you will never see that. We don't have the policy framework to run the business, whereas if you went to New Zealand, New Zealand is a great example because that airline was renationalised in 2001 so the state owned about 84 or 86% of the airline. Now that state ownership is being diluted to about 53%, well first of all it's a great airline, it's won world airline of the year twice recently, it makes good money, it's resolved it's geographic disadvantage, it's invested in Virgin Australia, it's got commercial relations with Etihad and Singapore, it's done the business. They're looking at getting rid of that 53%, they are never going to just on the one hand, own that airline and open the market to a bunch of state owned airlines who will come in and raid the place, that's what happened here unfortunately, that's what happened in Australia.

Although on the New Zealand side Emirates now fly double daily flights to Sydney, Melbourne and Brisbane, then they transfer those planes on to Auckland. They have morning and evening departures out of Auckland three flights a day to the respective cities.

That was only allowed once Air New Zealand was in shape to compete, so yes New Zealand tourism have a lobbying position not dissimilar to SA tourism, in regards to transport in New Zealand, "we need more airlift, more airlift, more airlift" but it was done over a long period, whilst Air New Zealand was restructuring its business, lower unit costs, refleeted, network aligned demand, much better discipline, and then all the lovely commercial stuff. What's happened in India is these guys just opened the market in one go, what has happened in SA has been big step changes, not one go, but big bites. Emirates went from one to two frequencies, and the SA government is quite naive about what's going on in the world, unfortunately. I actually had a discussion with the permanent secretary of department of transport in Australia, I was on panel with him at a conference a few weeks ago. He presided over this period when the Australian market was opened, and he acknowledges now, that they pulled the trigger too early.

So it's timing and pace?

Yes timing and pace, here they just have bilateral negotiations and they don't even know what's going on at the other end.

Emirates is utilising the poor timing and pace of our changes? Are there other carriers in South Africa that's done the same?

Not really.

So everyone else has played ball?

No it's not a case of playing ball, it's a lack of appreciation of what Emirates's geoaviation strategy is, it's to build a sixth freedom hub out of Dubai, it's that concentric circles thing. And the trouble is, we do frequency based bilaterals and not seat based, we do seat based when we have to, I think Mozambique is seat based, but a frequency based bilateral into a state that has an airline, that only has a wide body fleet type, and one includes the A380, if somebody cannot understand the consequence of doing that, the potential consequence of doing that. They now operate four 777's a day in to here, one a day to Durban and Cape Town, they already 104% of our scale. They have A380s pouring into their order book and coming out of their factory, they got to use them somewhere, they being pushed back into Europe, they being pushed back into North America, if you are in treasury at Emirates, you got a return on capital of margin on each A380. They will get to the point where they have so many A380 coming through, they will say we just running out of places to put these things, therefore the route that is currently 777 becomes A380. Not a four a day, but maybe two a day, so if you put two on and get that return on capital margin, drop it two percentage points and Johannesburg becomes a A380 route, it's only got two a day, and Emirates become 130% of scale, and there is not a damn thing these guys can do about it, because of the rod they created, they just not thinking through whereas Canadian department of transport, the German department of transport fully educated by their national airlines understand that totally, the UAE just tried to pour into Canada, but there is just six frequencies a day now, three for Etihad, three for Emirates, nothing else. The only port apart from Johannesburg with more Emirates capacity focused on it daily is Heathrow. We have got far more capacity focused on it here than they have at Charles de Gaulle or in Milan, or in New York. South Africa has been an easy mark, and unfortunately you can't wind that stuff back, unless you want to start a diplomatic incident, or trade war. It can't be wound back, you got to adjust your local aviation industry for what has happened, because there is no going back.

We spoke of regulations as you see it, in South Africa we had a recent case of the Tanzanians wanting to fly into Johannesburg and there were some ownership issues. If those regulations were not in place, how would the South African market look?

If any African airline could serve, the Yamoussoukro had come to pass, by now Ethiopian, Kenya would control Africa, the problem with BLUE DIAMOND AIR is the hub is too far South, we have to do a hub displacement, replicate our hub higher in a hemisphere position, it's one thing we are trying to do. Ethiopian for example, where their business is run well, they have got a whole of state aviation policy framework, that allows them to make decisions and deploy capacity very quickly. Ethiopia has a very special relationship with China, China-Africa development fund, the industrial and commercial bank of China, have just put 500 million US dollars into their fleet replacement program. Now if the markets opened tomorrow, and I was at Ethiopian, I would just redo my potential growth and get another 5 billion from the Chinese. The fact they can make decisions and deploy fleet very quickly, it's something we can't, because we have to get approvals from government and lobby people. If you got an impasse at Ethiopian airlines, you simply walk next door to the ministry and sort it out, if it does need to be sorted out, you probably walk next door and say "why hasn't it been sorted out?"

You spoke of moving our hub north?

Or replicating it

What would a whole new Blue Diamond air look like from that?

We only busy doing it now.

That would all be based on the liberalisations already allowed?

Yes and no, it’s not intended to be equity based, we can simply do this on a commercial basis. It’s totally aligned to what Virgin Australia, Air New Zealand, TAM have done. First built commercial relationships and then if equity comes along in the future, then look, do we really like each other? We're not in a fit state to contribute equity, there is so much we can do commercially, code shares, joint venture agreements, there is plenty willing investors out there. The main thing is to pick the right commercial partner, so we have got the right jurisdictions, we just don’t have the right local partner, and SA has had some spectacular failures in the past we don’t want to repeat. Thats the small part of it, the main part is getting our business right, getting our policy framework right, getting our fleet right, this is the main game, a hub somewhere else is important for the future, but it doesn’t help us in the next two or three years.

Do you think complete deregulation will ever happen?

No, well not in my lifetime, I can’t think of any other industry that was regulated, that is now completely open. I can’t think of one. You think automotive, lots of consolidation there, lots of offshore production, but there are still tariffs and import quota's, telco's still have lots of states with regulations about what percentage of their telco's a foreigner can own. Some industries are seen as essential, for good or bad reasons.

Do you see an airline being a key strategic asset?

A state airline, yes. Sept 11 is probably the best example, if you went and took the number of government officials and heads of state stranded because of Sept 11. When the shit hit’s the fan, let’s say, that Iran attacked Bahrain, which is not beyond the realms of possibility and there was a significant conflict in the Gulf States, do you think an Emirates will keep operating because they have to come to South Africa? They will act in their own state interest. There is a very strong argument still, these events are few and far between, that in times of crisis you need an airline. Now are you prepared to fund it yourself? Probably not a good idea, it’s good to have your own, that someone else is funding that is successful, because then you can commandeer it. I just can't see markets ever being totally open.

Is it not a paradox, the state wants the value of the asset and at the same time, they don't want to pay for it.

Yes, and there are plenty of cases like that. Let's look at some open markets, so EU and US is open market, United and Lufthansa have what's called Atlantic plus-plus which is an ATIJV, I have never gone and looked at this, but I have looked at plenty of other competition commission decisions elsewhere, often competition authorities don't approve these ATIJV's which essentially distorts an open market, so liberalisation becomes total on paper, but someone says that's open, I am going to put this relationship in place that distorts the market. So they use the open market, to close the market in part, through antitrust. Often these competition authorities don't approve those relationships, they simply decide not to object, and there is plenty of cases like that, certainly in Asia Pacific, where this is more common. You could argue what is an open market,

Question the definition?

Yes, EU, USA single aviation market, Australia, New Zealand single aviation market, ASEAN single aviation market, and there is all sorts of permutations and combinations, there is a South America-Asia Pacific thing called Maliac, there is loads of these around, but they all got distortions in them, so yes they are open markets on paper, but if someone takes that open market and distorts it, usually more than one airline, so two or more airlines find a way to distort an open market, so the market is not actually open. There is a really clever guy, ever heard of a guy Dr Alan Tan he is at the national university of Singapore, I am no expert on these things, but Alan Tan is an encyclopaedia on this stuff, he has made a strong presence for himself. You want to see if he has anything online where he talks about this stuff.

That will be good. We are saying that it can't happen. If it were to happen, the winners we have already spoke of the consumer, consumer welfare.

Absolutely! There would be less airlines, airlines would be bigger, greater economies of scale.

So winners and losers?

Winners would be consumers.

Do you think airlines would buy other airlines and consolidating into five or six global carriers, or would they start from scratch Emirates style, say a white tail type airline?

It's going to be a combination of new entrants, the barriers to exit, most markets we talk barriers to entry, in aviation we talk barriers to exit. It's the inefficient capacity, being prevented via subsidy or whatever from exiting. It would be combination of new entrants, exiting inefficient capacity and consolidation. That would be the three broad categories.

Not in our lifetimes?

Well increasingly so, you follow Etihad's model, that's been done before, Swiss air did the same thing with the Hunter strategy. There are some key differences and some similarities between what Etihad are doing. Most of the airlines acquired needs restructuring and order recapitalisation. Some of them have management contracts associated to them, rather than just investment, so Etihad at Air Seychelles and Air Serbia, but the differences are, Swiss Air was a listed entity without the money to do what it was doing. Etihad is backed by a sovereign wealth fund, which has given it a substantial growth fund with no repayments for long periods, with no interest, and other substantial free kicks, that's another element to the naivety of the South African government they don't understand if you open your market, to a state without competition law like Emirates price below the price of production, now if Emirates were in the EU, we could do something about that, but quite clearly, the price below the cost of production. So do Etihad so do Qatar airways, no competition law, and different consequences to opening your market to someone with competition law, compared to someone without. It's the nuances that are not understood.

Etihad’s strategy is not new, but the way they doing it is different, but they will come up against the same organisational and behavioural elements, like the bandwidth required to consolidate and integrate to extract the synergies, you end up with the same people doing as, they trying to extract the same opportunities do the same due diligence, do the transaction, in the end you put less and less skilled people on the new stuff. James Hogan is a very clever fella but people have tried this before, but maybe James gets hit by a bus next week, what if he is not there, is there anyone else that can carry that on?

Air Seychelles took Manoj,

Manoj is up there, Manoj is a Etihad alumni, that was part of the move where they got Gary Toomey out off the rack in Australia brought him to be the Jet Airways CEO, and then he couldnt work with chair of Jet Aiways, and that was Cramer Ball, who was at Air Seychelles. He actually had the Jet Airways job at the same time the Manoj deal happened but it couldn’t be announced because he didn’t have the work permit, there was pushback from various airlines ganging up on the Indian government, that turned to be a win win win.

That’s been a part of their consolidation process?

Well in the case of Jet, it’s not a management contract, in fact specifically management control is obstructed by the Indian government, with their lobby group of the other airlines, but the Seychelles specifically is management. They provide fleet, maintenance, management, commercial services everything, it’s all under various agreements, including the CEO.

After this interview, I gather you have worked out the direction of my research, is there anything specific you would like me to investigate, consider, on to the research, or any pointers in the bilateral and ownership space.

Well I think if you talk to people in other industries, I think the point we touched on a couple of times, the point of comparative pace of liberalisation and the subsequent consolidation, so the new entrants, the consolidation of existing market participants, exit of inefficient strategy. I think an interesting element would be was is the experience of other industries? I think Telco's, Automotive, Brewing and various elements of FMCG, petrochemicals, that was probably considered by many to be a key strategic state industry at one point, lots of jurisdictions have foreign investment review boards, they have special categories for certain industries, so the distortion of that market consolidation is happening, and I want to know what the different experiences are across the industries. So Daimler and Chrysler merged, but how was that facilitated, presumably you couldn't wonder into Detroit and buy Chrysler, it had to be a change of policy or that policy change, or instruction or some or other signal from government that they would entertain that sort of deal. Same in Europe, look at the investment in the EU car makers by the Japanese and Chinese car industry, the same argument must be going on in industries that people are familiar with, I would have thought that to be an interesting angle.

In terms of consultants coming into the airline with other practices perhaps from other industries, have they been a good or bad experience, or do you think the airline industry is so unique that has to be undertaken internally?

I can speak because I have worked at a range of airlines in range of places, as both a consultant and an executive, and I have seen both good and bad experiences, but to say they any different if I worked for Edcon and had been there for ten years and you asked me what my experience had been with consultants my experience I think would be the same.

What do consultants do that make them stand out as good?

The really good ones tell you something you don't know, they bring IP. That was my specific role, and I came here during Siza's time, and she thought I would just do some strategy consulting, but there was nothing here. Most of the major changes in global aviation come out of Asia Pacific, lots of companies are putting people in Asia Pacific. I was working for the centre for Asia Pacific aviation for a while, and they put me with American Express in Singapore, American Express has three people, two from the USA and one from the UK office, and they were all airline account type people, and they were there for a year to work out what was going on in Asia Pacific, when would come to Europe, when would it come to North America.

So is that the test track for the aviation industry?

Yes, the biggest thing going on in world aviation is probably the integration of low cost airlines into narrow body low cost operation into a hub via a low cost airport infrastructure, which allows for high volume interline. That's the biggest thing coming now. Because low cost long haul on its own can only work to point, but you can never extract the real value from it, because 60% of their cost compression between full service and low cost comes from high fleet utilisation and greater seat density, international airlines already have high aircraft utilisation. For instance if you operate trans-Atlantic it may be as high as 17 hours a day, which is pretty good. Actually even people like Tony Fernandes who ran Airasia X, he started his own low cost long haul outfit, and yes they had some sort of, people booking point to point, well Tony said we have this new terminal at Kuala Lumpur why don't we just run it as a hub, and see it what happens? It worked, and I think it has gone through the roof. Scoot in Singapore, Singapore Airlines subsidiary are now working out how to integrate their network into Tiger who are the low cost narrow body outfit that Singapore still own a piece of, and the you got Nok Air over in Thailand that's the Thai airways low cost subsidiary they did have international operations that failed, they now domestic only, but they just set up a JV called Nok Scoot, and they just acquired wide body fleet to do the same thing in Thailand. This is not only made possible by airport authorities building truly low cost terminals, it's also made possible by new fleet types particularly 787 800 and 787 900 which the LCC are ordering. The A330s are also being adapted. The next one doing this is Cebu Pacific in Manila, 9th of September 2014 they have the their first A330 all economy, I think it's the densest real estate in the world, 436 seats or something, running Manila to Sydney, and they already got quite a substantial narrow body network around Asia, they look like the number three and thats the biggest thing going on this year.

So from Manila they use A320 or 737 into Asia?

Yes

And then the first A330 goes Sydney, where would be the next point they go?

It has been announced, four other destinations, but I can’t remember.

But they all eight hour type flights?

It’s one in China, yes the eight hour, or seven to nine hour jobs. The big sectors Airasia did to London didnt work.

It’s too far?

People say "I am not going to sit with my knees jammed in my chin, Ill do it for seven hours but not for 14 hours"

Which is very different for Africa, as we have to ask where is the seven to eight hour concentric circles around us?

Ethiopian have worked that out, but Ethiopian has been disappointed by their 787 operational performance, but the have also got A350s on order, which changes the game. The 787s Boeing was wrong, they can’t operate non-stop to the US, so they still running through Europe, Rome I think it is.

INTERVIEW ENDS

9.4.5. Transcript 5: Interview with CEO at a South African based airline

My first question regarding regulation, the airline industry is well defined in terms of regulatory environment, in terms of ownership and bi-laterals specifically, do these regulations enable airlines or are they onerous to airlines?

It's a bit of a combination, I think it depends on how mature the markets are, so in mature market where you got large volumes of passengers, particularly the likes of transatlantic and in Europe, and in the States etc, there is clearly significant scope for competition in those markets, and for new entrants into the market etc. In Africa where most of these routes have tiny volumes, it's actually and one of the things we do see in Africa is in most cases the airlines are state owned. In most cases there is no incentive for private air carriers to get onto these routes simply because there isnt enough traffic to justify another entrant on to the routes, but the ideal scenario would be to get the state airlines out of the equation because they tend to be completely protectionist of their routes and therefore they don't open it up to competition. But the ideal situation would be to have private airlines has probably still with constraints on the amount of capacity simply to encourage participants to come onto the routes in the first place knowing that they got a chance, so that they won't simply be swamped by another five carriers coming on to the route and killing it off completely, so it's a bit of a mixed bag at the moment I think the African environment with a combination of state owned airlines and the constrained bilateral is sort of the worst combination that one can have simply because all that happens is the state's owned airlines block the route completely, and then provide really poor service and exorbitant prices etc. Yes it has got it's pro's and cons it depends on the external environment operating that one is operating in.

The state owned enterprises, should still go through a separate government department to negotiate the bilateral for them, does this happen with bias?

In most African countries the airline runs the Department of Transport in this policy, so if you take a country like Angola even if you get the rights to fly into Angola you have to negotiate what they call a commercial agreement with TAAG before you allowed to operate, now that is probably one of the worst examples where they actually openly say to you, listen you have got to negotiate with our state carrier as to how whether you can come up with a suitable arrangement that they will allow you to operate. In many other countries you find that the national carrier basically decides, you know what is going to happen with capacity.

Independence.....

The independence at the State Department is usually very sketchy at best.

And that's an African situation?

I don't know how prevalent it is in other in other countries, you probably if you take a place like India, it's still got a huge amount of protectionism but I think because of the size of the of the country in the number of airlines operating it would be difficult to to have an airline influenced policy when you have that scope of competition. When you have got only one carrier in the market and typically it's a state owned carrier then definitely, who else is going to stand up and fight against it within that country. We do see typically that if there is, you know if we talk Zambia that whilst there was a private carrier in Zambia, then all of a sudden, and this is before the collapse of Zambian Airways, then all of a sudden there was pressure from within Zambia to have a more liberal policy on bilaterals. Because all of a sudden you had a private carrier that wanted to grow across border, but as soon as you down to only a national carrier, then the national carrier is the department of transport.

If you separate the bilateral and ownership dimensions, what in your opinion has the biggest impact on the way the airline is run. For instance the ownership constraint of 25% in South Africa, 49% other countries.

Again it depends on the country and the amount of competition in the country and the number of airlines in the country, definitely we have seen the consolidation of airlines in the last few years has probably produced greater benefit than excessive competition in the industry. So you see particularly in the US substantial consolidation, we have even seen in Australia's some consolidation, Europe has lost a few carriers and there is more consolidation occurring there, and is actually bringing prices down because of economies of scale as opposed to expectation it would drive prices up because of less competition, so it's a little different to what think was the anticipated outcome was going to be, so the whole ownership issue at this stage, is really what's preventing further cross-border consolidation. So whether that relaxing of ownership regulations would be a good or bad thing the again in big markets where there is sufficient competition, you know a cross-border consolidation of a couple of airlines isnt necessarily going to kill the total competition between countries, but again if you looking at the place like South Africa, if we took away the ownership regulations and we got the likes of an Emirates coming in and just buying up the South African carriers, with only ourselves and BLUE DIAMOND AIR, then it could have negative consequences in that the country won't have any ownership of any competitive within its own domestic market anymore, so again it depends very much on the size of the market, eliminating a small country with only one or two internal operators, eliminating those could be disastrous. I think that on the long-haul it's a different story, long-haul operations are a very different ballgame and the kind economies of scale necessary on long haul operations seem to be more beneficial to have a bigger operation even if it is coming from an external country, then in the small domestic market where you can operate with a few smaller competitors and you need to have that local focus to keep the pricing within the local markets affordability. That's the ownership component and you said the other component you want to look at was the bilaterals side, which is more constraining, every market is unique.

Would Silverair have an issue with scrapping bilaterals across border, would it be benefit or negative?

I think markets across border are so tiny in Africa at the moment that if you take a route like Harare at the moment, it just breaks even, between ourselves in SA and occasionally Air Zimbabwe when it is operating, there is plenty of capacity on that route, if another operator came in on that route we would probably pull off because it wouldn't be worth operating with more capacity on that route, so then one has got to say what would be best for the market? Have the bilaterals in place constraining more operators from coming on to the route, then having two mature operators on the route that are doing a good job or is it better to open it up have more people give it a try, probably destroy the feasibility of the route and then what are you left with you don't quite know what you are left with. So again it depends on the quantities of travel on the route, so what happened with Nigeria a few years back when Virgin Nigeria started operating in competition to Blue Diamond air, but here again we are dealing with a state owned airline on the BLUE DIAMOND AIR side which distorts the whole dynamics of a free-market environment and I think that's probably got to make the distinction in terms of bilaterals good or bad. But what happened was there was quite a big opening up of the capacity. BLUE DIAMOND AIR had been charging a minimum of R14 000 to get to Nigeria, flights were booked up two weeks in advance, from what we can see they were artificially constraining the capacity to keep the airfares high, and Virgin Nigeria came in from the other side, but here in a normal free market environment if BLUE DIAMOND AIR wasn't state owned there probably would've been a sensible approach to the competition coming in from Virgin Nigeria, BLUE DIAMOND AIR might of pulled off a little bit of capacity to balance it again, they would've kept the prices a little bit lower but still on a profitable level, instead what happened was they dropped the fares to R2 500 and inevitably just trashed the route completely in terms of feasibility, and Virgin Nigeria pulled off again and the fares went back up to R14 000, so it does depend on whether you have got rational competition cross-border as well. If we look for example at Kenya Airways and route into Nairobi again unfortunately you got BLUE DIAMOND AIR on the route, but if we had put capacity on to the route in competition with Kenya airways we probably would have seen a rational reaction, and would have probably been feasible to simply open up the capacity, and say both carriers are not going to behave stupidly because they both need to remain profitable, but what happens if we go on to the Kenyan route now BLUE DIAMOND AIR will try force us off, drop prices to levels that they make huge losses, but so what? So I think maybe the state ownership issue plays a bigger role in all of these policies in terms of how they play out, because you can't actually work on the assumptions of rational commercial behaviour when determining how the policy is going to impact on the industry.

If State ownership is the main criteria, could the industry regulate to the point where there is no state ownership? Is there a need for a flag carrier?

No in Europe they are disappearing very fast because of the competition law in Europe around countries not being allowed to fund their national carriers. They got certain criteria in which they can fund them but it's very restricted, so we are seeing that the flag carriers are disappearing in Europe very quickly and obviously the US hasn't got any state-owned airlines, South America has pretty much got rid of all of it's state-owned airlines and so what? It hasn't made any difference, it's increased the efficiency of carriers, brought down travel costs, if we look right now at South Africa is the Cape Town London route, BLUE DIAMOND AIR used to fly Cape Town London amazing enough they claim they couldn't make money on it, despite the fact that Virgin and BA say it was one of the most profitable routes in their network. So now what has happened is BLUE DIAMOND AIR has pulled off the route completely BA has thrown in lots more capacity, the prices have actually come down and for the person travelling out of Cape Town there is plenty of capacity it's made no difference, all that has happened is they fly BA more often now then what they used to, so this whole flag carrier issue is becoming fairly irrelevant these days. I think if you look at, we have been approached a few times by countries in Africa, who actually want to start a national carrier, and usually it's countries who don't have very much money to start with they typically come out of a civil war, and they want to re-establish the country and those kind of issues and our advice to them has been, and they typically come to us and ask "don't you want to coming in as a technical partner to assist in establishing a national airline?" and we say "look to be quite honest you probably got bigger priorities for your budget then to fund a national carrier why not go, and it sounds counterintuitive but go to Emirates or a Qatar and we will give you exclusivity for 10 years to provide connectivity from our country to the rest of the world, will use Dubai as a hub and we don't need our little country to be the hub for the world, and then it costs them nothing, they get a free airline connecting them to the rest of the world, so why do they really need a national carrier at all surely there are bigger priorities? Look this whole flag carrier you got to separate the flag carrier from the national airline you can have a privately airline being the flag carrier. American airlines is a private airline, it is very much the American flag carrier, but a state-owned airline is a mystery, surely governments have got more important things to do than fund an airline, look if you sitting on I suppose a place nobody wants to fly to, I don't know, can't thing of anywhere. But then rather subsidise a private carrier to operate specific routes and then ring fence how much you prepared to subsidise, put it out tender, you know this connection between China and South Africa if there was such a big political requirement for South Africa, they should've gone out and said we putting it out to tender, any airline in the world can contend for this route and whoever can come up with a contract for whatever five years 10 years with the lowest required subsidy that airline will get the route, and the condition is you have to operate the route for that period, we will pay you that subsidy and then it's contained you know exactly how much you are going to pay for that open route, you don't have this open bottom pit of BLUE DIAMOND AIR where the government keeps throwing money into it, just to try and keep it going, but why do you needs the flag carrier? You need the connectivity between the countries, it doesn't matter what flag is one the tail.

The 44 Chicago convention speaks of it being key to military needs....

That's very old.

44 convention still exists.

I know it still exit's, bizarre, no I think that's completely nonsense these days, if you look at how countries lease in capacity from other countries for military operations, there is clearly no need to have your own, commandeer their air force, you don't commandeer their own shipping lines, and they don't commandeer vehicles from their own state-owned department, so why do they have to commandeer aircraft?

So in times of war, rely on money talking?

Money will talk. It's far cheaper in a time of war to go out there and lease in a whole lot of plane from private contractors than to spend 50 years subsidising a state airline just because maybe one day you will go to war, it's quite bizarre, and there are so many contractors out there, leasing companies and charter operators that will come in and fly in any place in the world, you see all the charter operators flying into the Sudan and Eritrea, into Iraq etc. there is no shortage of contractors who are prepared to fly into these places if you pay them to fly.

We spoke about flag carriers, or state owned enterprises not having a place, one of the things I have noticed in the interviews thus far, is that Emirates, Etihad and Qatar come up often, those are....

They are basically state owned, but I wouldn't even regard them as just being airlines in isolation, they really are part, of a total economic design, same with Singapore, it's not an airline being funded by a government in isolation it's part of a total national strategy, so I see them differently in that regard, and look if there was a way that BLUE DIAMOND AIR for example was incorporated into a much bigger national strategy with clear links into other benefit's across the economy then maybe there would be a logical place for it, but at the moment there is no requirement for BLUE DIAMOND AIR because it doesn't actually follow through to other benefit's the only BLUE DIAMOND AIR can deliver to the country, so whether BLUE DIAMOND AIR brings a link to tourism, it makes no difference whether BLUE DIAMOND AIR brings in a tourist or someone else brings a tourist in. No no Dubai wouldn't have evolved the way it has without Emirates you wouldnt have got the current capacity flying through Dubai from all the other carriers in the world, so in that cases Emirates was a critical part of the overall strategy, same with Singapore.

Then it is justifiable?

Then it is justifiable it's not, it isn't there for the sake of being an airline, it is there for the sake of the biggest total economic requirement, I suppose it should get to the point where Dubai doesn't need a, and they claim it's not state owned but ultimately it's effectively via the shareholders, it's state owned, it should get to the point where they can have a properly privatised airline if once, or if Dubai becomes a genuine economy of it's own which is also questionable, it always seems like a bit of a disneyland that if something goes wrong they might just shut it down one day, in that regard they may need a state owned airline. If they can mature that economy it should get to a point where they say they no longer need a state airline anymore because there is enough interest at that point, but it's been set up as a unique situation, they have never, they set it up to try and get traffic to Dubai but they also set it up very much as a global hub, so if they privatise Emirates or shut Emirates would it remain a global hub or would the hub move to Frankfurt or to Abu Dhabi or somewhere else? It's a bit of an odd one, it's the odd fish in the whole equation.

In terms of Geography is Dubai is in a prime spot?

Ya, fantastic I can't think of many places better than Dubai.

You spoke long-haul, if we separate long-haul from regional and domestic, you said long-haul is a different ball game, and that consolidation in that line, leads to economies of scale, is there a point reached where there is no longer economies in scale? The reason I ask is that Dr Iatrou in his textbook says that in the airline business once you reach twenty of a type of aircraft, there are no further economies of scale?

I wouldn't be quite convinced, if you look what's been done with the CONSORTIUM A group with Iberia and British Airways, you would think that BA on it's own must of lost economies of scale if that theory holds or Iberia itselfhas lost economy of scale, but simply by putting them together as CONSORTIUM A they already achieving further economies of scale. So I wouldn't be that quick to discount the ability to simply keep growing those economies of scale through growth. I think that there must come a point where in even a big market like the transatlantic, could loose it's competition by too much consolidation, so it does get to a point where competitive benefit will actually suffer from consolidation if it just goes too far.

Where are the economies? Is it buying power?

A lot of it is distribution methodology and being able to sell in different markets, geographic cross selling etc. so for example British Airways didn't have any real presence in South America but Iberian had significant presence in South America. So what you find is people flying into Spain on Iberia and then any route that Iberia didn't operate from there they could end up any other carrier, where as now they almost certain to end up on a BA flight, so in that regard BA has leveraged off Iberia's distribution in South America and likewise Iberia is leveraging off BA's distribution in South Africa, Iberia doesn't even operate into South Africa anymore, if someone is going to Spain now they very likely to fly BA to London and catch an Iberia flight to Spain. It has meant rationalisation of some of the duplicated capacity of certain routes that wasn't necessary and the benefit of cross utilising distribution capabilities in different markets, and then there are some back-office savings as well they both moving on to the same frequent flyer platforms with Avios now, so instead of running their own isolated frequent flyer programs which on their own had limited global appeal, they now moving on to a genuine global flyer programs with a single back end and I'm sure that one will see more common back office system utilisation etc. as they slowly but surely move in to procurement of new systems. Why would BA now procure a revenue accounting system only for BA in the future, it will look at it from an CONSORTIUM A perspective and say what's best for the entire group from a revenue accounting back-office, and then just consolidate it into one back office, but it needs to get to that step where ultimately that need for the new system, or the new process, or the new equipment arises and then they will stop looking at form the perspective of one airline but look at it from the perspective of CONSORTIUM A group, so there is lots that can be done, through that ongoing leveraging of that bigger airline.

Speaking of CONSORTIUM A, that is a new corporation, that has effectively removed it's geographic flag carrier from the company. If other carriers bought into their process, to form part of this group, you have almost taken the global alliances to the next level.

It's almost a way to get past the ownership problem, so even Air France/KLM merger that was probably the first big really big mega merger, CONSORTIUM A is almost the also-ran in a way. Now we got the likes of the Qatar's getting into air Seychelles and into Darwin air in Switzerland and into Alitalia so is happening, and it's happening on a cross-border basis on some rather questionable ownership structures to bypass the ownership limitations, so yes it is very much the next step in the what was originally thought to be a solution with simply having alliances, where there was a commercial relationship, but that never delivered the kind of benefit's that were anticipated and you can see from a organisational dynamic perspective it's very hard for airlines in different geographical locations ith different cultures, and different management teams to really have a single vision of how to cooperate, you do you need to have a single management team at the top saying listen you guys will do this and from the bigger picture perspective this is what's best for all of you in the bigger part, because typically what is best for everyone will always be to the detriment of one player somewhere, so the original design of alliances didn't really deliver anything, the little level of cooperation on frequent flyer programs here and there, but there wasn't much that come out of it

Previous research says they were successful, do you think they were successful but not to the anticipated level?

Not to the anticipated level, I think it probably did constrain a little bit of the competition between alliance partners so it stopped them from predating on each other's routes, which in that regard they might regard them as successful, again whether it was good or bad for the consumer is very hard to tell, it might have been good by creating stability, and some certainty for the operators on the routes to say well we know that it's worth our while to invest more aircraft, or more capacity or more better service on this route because we not just going to be killed off by the next entrant, who is now part of our alliance. The other side of the coin is well did it reduce competition and therefore give them such confidence that they could push fares to such unacceptable levels, but then again if you look at the global profit margins on airlines, one can hardly consider any airline to really be exploiting the consumer.

Do you think that one of the failures of the alliance is that some carriers were more equal than other carriers?

Yes, it's always the case, it's like South Africa being a member of BRICS, we're nothing in the BRICS environment, we there only by name, you know China doesn't give a stuff whether South Africa is there or not. I think it pretty much was the case then also, there were also these conflicts occurring where you had these strange other partnerships that certain carriers within the, or competition within the alliances. For example, Lufthansa has KLM as a big competitor, KLM has got a big shareholding Kenya airways, therefore Lufthansa wouldn't want Blue Diamond air to do anything with Kenya Airways, but Kenyan and Blue Diamond air are the two logical big carriers in Africa so you know that's the politics of these alliances that constrained some of the relationships that individual carriers would want to have, and a bit of the same with us, we had the same issue with, same issue in fact with Kenya airways we managed at a time when Oneworld was trying to woo KLM into One world before it tied up with Air France as part of their wooing strategy they allowed us to do a codeshare with KLM but of course as soon as KLM joined Air France this codeshare between BA South Africa and KLM became big bugbear for BA it was too late, they couldn't do anything about it, it was all set up and that was it, but certainly wouldn't allow us to extend it beyond KLM to Air France, Air France is the enemy number one of BA, but it also meant we couldn't do codeshare between BA and Kenya airways until we put one in place between Kulula and Kenya airways. We always wanted to do one with KQ but couldn't do it under the BA brand because of One World BA's relationship with KLM Air France so yes it’s got it's very funny consequences that were not seen from the outset and again it becomes this issue that what was good for the alliance, wasn't necessarily good for the individual carrier and therefore typically some of the individual carries started fighting back against their own alliances. We see a bit of unhappiness from Lufthansa at the moment with all the deals South African is doing with other African carriers.

And talking of upset in the existing alliances, Qantas is a founding member of One World, but doing a lot of things with Emirates...

Well they out of One World now.

Are they out?

Ya, they have picked Emirates now as their partner which we will see, I think Qantas will just become part of Emirates, you know Emirate doesn't do alliances with anyone else unless they planning to ignore them completely they don't, it’s interesting. Working with Emirates even Qatar, they don't have that, they have the mind set of being completely independent and being able to do it all themselves so they extremely.. Ethiopian as well in a way.

Can Emirates do it themselves?

Probably, there is so much money behind it, they probably could take over the world.

And if they were to absorb Qantas, but to appease the Australian public keep the kangaroo?

Oh look they will keep the kangaroo, from the outside the passenger will think it's the same.

So it's not a branding, they looking at the actual airline asset.

No no, they are looking at the actual running of the airline.

So it's operational?

You will find that functionally it is the same as what Qatar has done with Air Seychelles and with Darwin Air, they have taken minority stakes but you're under no illusion that Qatar runs those airlines now.

True, Manoj is now CEO at Air Seychelles and he was at Etihad for a few years prior, before going back to BLUE DIAMOND AIR for a while.

The guy in Darwin Airlines, I spoke to him at a conference in Dublin, he says they have a management conference call every Monday morning and they basically get told this is what you're going to be doing in the next week by Qatar, he has no say in the business anymore, it's a Qatar business now, you can keep your branding but we in charge now.

So we are going back to CONSORTIUM A, or KLM Air France these global corporations. They have spoken about these white carrier or white tail airlines, these global businesses, it didn't really matter what the tail had, but the core business was globalised, is that finally happening, because the airline industry is one which hasn't really globalised.

If you look at asset intensive industries that is typically where globalisation has been the most prominent, so look at the motor industry, the aircraft manufacturing industry, railways and construction, where you have big producers like GE, on big producer in China for railway carriages etc. there are just a hand full around the world and that's it, and how many motor manufacturers are there these days it's handful. The airline industries are much the same yet we hot hundreds of airlines.

Do we have too many?

Yes I think we do, just look at Africa, it's bizarre in Africa at ever country has got its own little tiny airline it's just not feasible at all, and that's part of the tragedy of what's happened to Africa and why the Middle East has taken over. If there was cooperation across African countries to have a single unified approach to aviation, then they could have stood up to the Middle East carriers and actually had a strong enough product to prevent the Middle East from basically taking over the African market, but there is no way the African countries will ever co-operate. There were huge efforts in particular in West Africa with there was very blatant effort to get West African countries to work together, and Air France was in the middle of it all, trying to coordinate it all, but in the end and they were nearly there but in the end what broke it all down was that all of the countries refused to relinquish the head office of this consolidate airline to any other country. So effectively they were going to have to have sever head offices, and you just can't do that. It just came down to politics they just refused to do it. America's has got two air traffic control zones for the whole of the United States, Africa has got 52, just because every African country wants it's own air traffic control regime and policies thats just never going to work, you just can't be competitive on that basis.

Why do you think Yamoussoukro failed?

Just politics, in theory everyone just said yes we will agree but no one was prepared to relinquish control of their airlines or their air space or their air traffic control, so the cooperation's never happened.

An argument has been made that the only benefactors of Yamoussoukro was the Middle East carriers?

Yes absolutely!

So it has been to the detriment of the local....

ya

Is that a failure of deregulation or a failure of this particular agreement?

Lack of political will and it's the exact same thing we sit with today. It doesn't matter how much the airlines themselves and .... another one of these conferences seem to come up every single year about cooperation between African airlines, and it's the same story over and over again last 20 years, the same thing be preached the same people all saying yes it's the right thing to do, even the government saying yes it's the right thing to do but you go and talk to any of the national carries in the neighbouring countries and government won't allow it it's their national carrier they going to run it on their own, they not going to cooperate with anyone else, never mind how logical it would be to cooperate, never mind how much they falling to pieces cause they can't keeping it going they will not co-operate with other carriers in other countries, it's tragic. Even just looking at the few southern African carriers look at Air Botswana, Air Zimbabwe, Zambian Airways, LAM in Mozambique they all tiny carries with no economies of scale, no ability to even afford backup aircraft for their fleet, because they got such a diverse collection of aeroplanes, no economies of scale to invest in proper IT systems which would make them efficient, and everything is duplicated and their number of staff per aeroplane is diabolical. It's so simply and easy, because Silverair is taken the lead in a lot of this investment we are sitting with massive capacity for economies of scale to absorb additional airlines requirements in our back office, so quite honestly for example if a LAM or Air Zimbabwe, or Zambian before they disappeared had come to us and said listen, we want to have a flag carrier in our country, but we cannot afford to run this thing, can you guys just take over the entire back-office function of our airline and effectively run the airline as a virtual airline? Easy it would cost them peanuts compared to what it was costing them to run two aircraft, with a full functional back-office, but no, they wouldn't allow another country to have access or to manage their airline, so no that's the consequence.

Do you think the so called dirty tricks of BA - Virgin battle in the early 80's ia an issue?

It's not an issue, because there is good competition regulation now...

From an African perspective, that they feel Silverair with your association to BA, and the access to their systems.

No, I think it depends if they want a proper partnership and they want to, it depends if you want to share the risk in the venture, if they came to us and simply said well, that they would take the economic risk and we must run the airline, I'd say they crazy. They putting it in our hands and hoping we going to do a good job, and it's all their risk. So that would work, but if you on a proper risk sharing basis, then we wouldn't want to damage, we would that airline to succeed as much as possible, there are ways to manage that very carefully. There is a huge suspicion of BLUE DIAMOND AIR, they have gone to a number of markets, and then pulled out causing huge damage. An example that is always cited in Africa is Air Tanzania. BLUE DIAMOND AIR went and bought a share in Air Tanzania, then they dumped a huge amount of capacity from South Africa, BLUE DIAMOND AIR into Tanzania and they pretty much killed off Air Tanzania in the process and then they pulled out and shut it down, and unfortunately that set a precedent for many other African countries when they look at BLUE DIAMOND AIR they say we wont touch them, we don't want BLUE DIAMOND AIR coming into our country. And likewise we have the same issue with many of the state owned carriers in Africa which wouldn't want to work with... because their mind set is bizarre, they got a whole different agenda and that's why we have had this extremely successful relationship with Air

Kenya airways, because they got the same commercial mind set, they don’t have a government mind set, but there very few private airlines in Africa who you can do that with.

If I had to give you a golden pen, and say for today you can amend any regulations, be they local or internationally what would you like to do?

I don't think the real issue is regulations quite honestly, I think the real issues is political will, that's the problem with it all. The regulations in themselves aren't necessarily a problem, in fact if you look at the likes of Yamoussoukro there a lot of very positive policies out there and if they were simply.. if there was a political will to comply with a lot of those policies etc. there wouldn’t be a problem at all.

So depoliticise the industry?

Depoliticise the industry that's the real.... if there was a way to regulate, I think probably what would be the Golden pen solution for me, would be proper level playing field competition law for Africa. Like you have in the EU, but first of all you need a proper African Union like the EU to adopt a common competition, now what competition law has done for the EU has been phenomenal in terms of specifically looking at state enterprises and if one reads old Judge Dennis Davis book called thieves at the dinner table which he wrote about the establishment of competition law in Southern Africa, he said that the biggest failure in establishing competition law in this country was that there was no section of the law to apply to state-owned enterprises and they are the biggest monopolies in the country, and yet they are not regulated by competition law, so and that's also been the failure to a large extent of Yamoussoukro because a lot countries are terrified that they don't have that protection from the like of BLUE DIAMOND AIR just coming in and shutting down their airline and swamping their country and it all comes down to proper competition regulations which have never really established, so that would be my golden pen to write African competition regulation and very much like the EU competition regulation with a specific focus on state funding and level playing fields on funding of airlines.

If we had to deregulate, with the caveat that you have strict competition laws, saying that you have to act in commercially viable mind set, how would the industry react? What would be the benefit's? Who would be the winners, who would be the losers, consumer the winner?

Ultimately the consumer would be the winner just because of the fact that one could achieve, the kinds of economies of scale that could make routes feasible for bigger aeroplanes, so if you look for example many of the little African routes you find that there are a number of competitors flying little 50 seater planes on the route, now a 50 seater plane has got a quarter of the capacity of a Kulula 737 800, but the cost is about maybe half the cost of operating. So your cost per seat is double a Kulula cost per seat and by consolidating, two small carriers, the local aircraft into one bigger carrier flying a 737 you could effectively halve the airfare, so consumers should in theory benefit from that kind of improvement. It would accelerate the ability to move into a first world low-cost carrier model in Africa, but what would the casualties would probably be the national pride of some flag carriers, the beneficiaries would be those governments probably because they wouldn't be throwing money into their loss-making national carriers, so the only damage would be the national pride, I think financially can't see any damage. The winners I guess would be the stronger carriers in Africa at the moment and the open skies if you deregulate I think it would probably still need to be some kind of African protectionism like you got in the US, in the US you got open skies within America, so anyone can start up an Airline in America's competition, but they limit foreign airlines coming in, so if you want to try and keep economic value in Africa you would want to say that we will deregulate within Africa like Yamoussoukro was intended to do but that doesn't mean that Emirates can come in and buy up all the airlines in Africa, try and find a way of keeping the employment and the benefit the economic benefit in Africa but on a scale that is actually feasible for Africa.

If we use the Air Tanzania BLUE DIAMOND AIR example, don't strip the assets and or the route?

Well it might have been the right thing to do quite honestly Air Tanzania was horribly inefficient poorly run business so if BLUE DIAMOND AIR was running on pure commercial principles and Africa was running on pure commercial principles, it's very possible the best thing to do would be to have one carrier operating on that route, and not have a very weak and inefficient Air Tanzania still fighting against it.

If BLUE DIAMOND AIR pulled out the route, would they not be left stranded?

While BLUE DIAMOND AIR shut down the Air Tanzania, they still operating the route with BLUE DIAMOND AIR, but they completely exploiting the route because they got no threat of anyone else coming on.

What about Fastjet?

They started now but BLUE DIAMOND AIR will kill them, there is no doubt about it. We flew for little while to Dar es Salaam and BLUE DIAMOND AIR just doubled the capacity, trashed the fares and we pulled off, and they doing the same to Fastjet and I don't know how long they will stick it out before they give up on that but again it's because BLUE DIAMOND AIR's got the ability to just trash the route and get the competitor off, if they were constrained by proper commercial in a non-government owned strategy they would be allowed to loose that much money on the route and therefore it would give a competitor a chance to move on which would mean that they would always keep their airfares competitive to stop new entrants coming on the route whereas now they just throw out the airfares to ridiculous levels knowing that if a competitor does come on they can just trash the route completely and get the competitor off again, so it really all comes down to commercial, taking genuine commercial risk, which means depoliticising the industry.

You said the stronger airlines would be the winners, how would you, or what would distinguish the losers?

I think the guys who got no economies of scale to actually invest in meaningful infrastructure and competitive infrastructure. So the little airlines with two or three aeroplanes, wouldn't be able to grow fast enough, to move fast enough to invest in what is necessary. You know if you sitting with 20 aircraft, you probably achieved quite a good economy of scale already, you got, you know moving from 20 aircraft into 30 aircraft is not the end of the earth it is a fifty percent increase... so what? Moving from two aircraft to 30 aircraft that's a whole new ballgame and those guys would fall behind because they wouldn't be able to grow at that pace to acquire. Those are exactly the ones who should fall of the scale in the first place.

You spoke of the 737-800 and the fifty seater, is there a case an RegionAir that operates a 50 to 80 niche, and could these smaller carriers reinvent themselves and add value.

Ya, as feeder airlines. There are still routes even with one operator on the route that won't justify anything bigger than a 50 seater, and that's where the 50 seater is all that is honestly required on the route. Africa is full of those routes and there is so many little places that will never carry more than 30 - 40 passengers a day so RegionAir flying into all these little points in Mozambique at the moment, that kind of thing until those markets grow there's nothing better than a 50 seater to deal with that.

Not every route can become a low cost route?

No no, but there are still lots of routes that are operating with three or four operators with little aeroplanes that don't make sense.

During our discussion today have I left out any levers that you would like me to consider or investigate in scenario planning?

The only one, and I don't know where this fit's in, but it might be worth looking at is, ultimately there is still and this is kind of an umbrella issue for the whole of Africa is that while some of these growth percentages look very good in Africa, they coming off such tiny base that you going to need many many years of that kind of economic growth to get to the point where for high-volume or highly efficient air travel can even come into the equation into the economies, so GDP growth in Africa is still an important part for many years to come before we can really start getting into the scale of operations that can produce really efficient air travel in Africa, and so we sit with a chicken and egg kind of situation where at this stage, people are saying if we had more volume in Africa not only with aircraft, but on the airports, on the air traffic control, on the equipment at the airports, if it was all utilised more frequently you could bring down the unit cost by spreading it over more flights, of more passengers etc. but it's a chicken and egg. Who is going to fund that breaking the cycle of inefficiency, so is it going to be the government saying listen we going to subsidise the airports and we going to subsidise the infrastructure to bring down the cost of travel, which will encourage more people to fly because airfares will be cheaper, or is it supposed to be the airlines that go in there with and loose money for a few years with cheap airfares to try and stimulate air travel, but that's not possible because airlines don't make enough money to do that. The only other way to do it is with consolidation, where you get the economies of scale out of consolidation, so in just in terms of the other alternatives to political will and consolidation is someone has got to throw the money into the system somewhere to make flying more affordable to grow the volumes, to achieve the economies of scale, and I don't know who is going to throw the money into the system? There is no one there, you know the countries don't have the money, the airlines don't have the money. So there really isn't an alternative to get this cycle going other than the long-term GDP growth, that's the alternative, is the economy throws the money, but then you have to have a growing economy for a long time to get the volumes there. From a macro economic level that's the alternative is long-term GDP growth and eventually it will get there just by default of typical economic growth.

What about growth funding through a state sovereign fund?

Whoever is prepared to throw the money in, but I think the trick there is that the growth funds typically don't ... they want asset-backed projects. Look at the world bank and the IMF, and the US government everybody else are prepared to fund assets in Africa, but they want to see the asset if you say to them just subsidise airports, or subsidise air travel in the hope that it's going to create economic growth, it's going to create volume that's the not the stuff they want to be doing.

Although an airport is surely asset based?

An airport would be asset based but they still want to see a plan for the airport, in terms of delivering a return that could pay for the airport. That they don't go in there and say "listen we will build you an airport, and then you don't have to charge anyone for it" they want to see good economic principles attached to the airport. And then of course the first thing that happens is that typically the government says shit look how much money we can make from this airport by charging every passenger 100 dollars, and you back to square one.

My last question, have you dealt with consultants in terms of your strategy formulation, or do you keep it internal?

No we have done a lot of work with Sabre who have a consulting division and also with Boeing, who have a consulting division, typically we find the airline manufactures have got a very optimistic view of how many aircraft we need so we take all their views with a pinch of salt.

What are the weaknesses what are the strengths?

The weakness are typically that they don't have a good feel for what really works in Africa and a lot of it if you look at Africa as an outsider you think this is all a little obvious, you can easily make it work you just got to get rid of this that and the other and you consolidate these airlines and you put more capacity on these routes and they will grow, but the reality is if you haven't worked in Africa and realise how long it takes to get things to happen, so we sat with the likes of Sabre after they had put together our Africa strategy view, and we said you realise that this will take 15 - 20 years to implement, and yet you saying we need to buy these aircraft today to start implementing this whole thing. What would you do to your plan if we told you that we would take five years to implement five years to implement each step of this plan? And they said 'shit it can't work" you going to be investing today hoping to make money in twenty years time, it can't work.

INTERVIEW ENDS

9.4.6. Transcript 6: Interview with CEO at a South African based airline representative organisation

In terms of the regulatory environment of the airline industry, specifically ownership regulations as well as air freedom points or bilaterals, the airline environment is well regulated. Do you think these regulations are beneficial to, or onerous of airlines?

I think at the time when they were started, there was a necessity to define the rules of the game, I think in terms of ensuring sovereignty of air space the rules in terms of the basic freedoms of the air - first, and second freedoms third and fourth are absolutely fine. However as we move now into a much more global environment, I think that the other reason which is important to start on the first and second freedom stuff as well, particularly you were building up a whole new industry, take the Chicago Convention from 1944 where this all started effectively, started to be regulated was from a safety and security perspective you had to ensure that that people flying these new aircraft around where actually playing by certain rules. That's were the whole ICAO and Chicago convention came with all the various annexes as they started to develop things, the annexes started to the extent where that regulatory process built up to the point where it became... aviation became one of the safest modes of transport around the world. If you'd allowed a free for all, it would have been an absolute disaster, it wouldve been a mess, and so the fathers of aviation had it right at the beginning in terms of setting the rules. As you start getting into now a much more global environment where there is a lot more, there is much more necessity for marketing, interlining and travelling around, especially now with the development of a lot of the larger airlines and a lot of the global carriers, the process even in terms of the 5th 6th 7th freedom traffic and possibly eighth which is cabotage was put there as a basis for saying if for example a particular airline or a state airline is unable to be able to perform a certain function, then let's allow the ability to satisfy market requirement and allow another airline the ability to fly those additional routes and to carry passengers which may not even be for between your two respective markets and then carry between intermediate points, so in that regard the basics are there to pursue the freedoms of the air to be able to enable that traffic to go so that you shouldn't constrain it, where I think we have probably fallen flat in many areas is that some of the states have basically said our priority is particularly our national airline, so we have a situation in certain areas where states have said we don't want to allow applications to certain of those freedoms of the air, and therefore they have actually constrained the development of the air, and they worry more about their own particular agendas and of retention of the flag carrier, then actually satisfying the needs of the market. So I think the intention of those freedoms and all the regulatory requirements was a good one, but we now at a very critical stage properly within the world situation of determining which way we go, do we completely open skies for me an interesting dynamic was when I was first working in the regulatory environment was the early 90s and I was working for BLUE DIAMOND AIR just so that you know that, and I remember going to the United States of America and talking to part of the delegation to renegotiate the US - South Africa bilateral. South Africa had at that stage just come out of 94, in fact it was pre 94, and there were negotiating and the United States wanted open skies, and that was it that was their opening gambit, and South Africa said we are not ready for open skies we only starting to get out of the whole isolation period, and getting back into the United States of America and everything like that so, and you could quite clearly see that they just said there was no need, and no worry about so it suited America at that stage they weren’t even thinking of any carrier flying to South Africa it was only Blue Diamond air flying to the USA, so from that perspective they had no problem and the Americans would come into Africa and say let’s go open skies, and they were able to negotiate open skies policies with Tanzania, there were never going to fly to Tanzania and neither was Tanzania ever going to fly to the United States of America, this was just to put these rules to show liberalisation in place. And then you get for me and I don't know, I don’t understand it fully and I don’t have all the background, we have got this US and Britain and the UK negotiating, and then you say the USA only negotiates open skies when it suit’s them, because for me there is quite a lot of liberalisation across the Atlantic but it still suit’s them, and you talked about ownership and control, ownership at the moment in South Africa is for domestic airlines for 75% requirement for for local and 51% for International, yet in the United States of America it’s 75% period. So there is a case of they wont allow it because it doesn't suit them and they want to protect their own airlines, so although they made out as the open skies guys, ownership and control is very much set, so I think the biggest problem, and an interesting development now is although we were going liberalisation, you take the Africa scenario the Africa Yamoussoukro decision which I am sure you are aware of, the Yamoussoukro decision had a great idea of liberalising within Africa, I have been a great proponent of the fact that you have to have a strong.... if you want to have an international reach you need to have a strong domestic base, as well as a good regional base from which you can feed and develop international, if you just have an international network you will never develop a proper international network because you don’t have the feeder network setting within your own company and country to be able to develop that, and so there has been a lot of development that area and that has largely said that the whole Yamasoukro decision was basically liberalise 3rd and fourths completely, fifths on the basis of, they started on the basis of 20% if you didn’t have third and fourth freedom traffic, that was Yamoussoukro decision/declaration of 1988 I think, 99 was the one that would allow fifth freedom if you didn’t have third and fourth freedom between it, but then moving towards the situation of saying ok let’s more liberalise more the fifth freedom traffic and allow it to go. But again this was a case that even with between states we didn't between the African states say with protective I will just say this because they were jealous .. for me jealous of each other, so they weren't going to give routes or envious of each other, so they weren’t going to give route rights, particularly fifth freedom rights to potentially a state who had a strong airline that could come in and show them up for example, and in fact they even went the route of allowing more rights to some of the international airlines like the Emirates and the Etihad’s that are coming into African now. Look at Emirates and what is happening in South Africa, even allowing that whole thing to develop in such a way that the African airlines are really taken a backseat now in this. Somebody said to me the day they believe and it's possible that because of what's happening and the way that some of the Gulf carriers have really taken off, those three carriers, competitors but working very closely together, there is no doubt in my mind that some of the other states including the EU, and the Americas, and Canada are going to pull back on liberalisation, and not allow these guys to just go free for all into the United States and all over Europe. My understanding is that Germany and France are giving them the Emirates and the UAE now a hard time, and not just giving them all the frequencies they want because they know very well that the Lufthansa's and Air Frances can provide all these big services but if you just allow the UAE they are just going to come in and take over the whole market.

I heard Canada has allowed six frequencies, three to the UAE and three for Canadian carriers.

And they just say it, exactly were are protecting ourselves against you guys and we know what your route is. I remember them saying, I was going to a conference a couple of years ago in the UAE and sitting with some of their pilots of Emirates and I said you guys are doing very well and the guy said ya, Tim Clarke said we are going to take over the world, that's it, that is our aim. Ya I don't know if that answers, that probably, I think it is that it's right, it was the right way but it does and it provides a framework to liberalise but it can also be detrimental.

A question I haven't asked anyone else, but you brought it up. If 44 is right, do you think perhaps instead of liberalisation it's just time to reengineer the framework rather than go to zero regulation? Or do you think zero regulation is the way forward?

When you say zero regulation, what do you mean?

Fully liberalised market, they say it's liberalising gradually and it has been since 78, and eventually it will move to zero regulation in terms of ownership and bilaterals. Do you think perhaps that is not the way to go, and perhaps we just need a reengineered framework?

Probably a reengineered framework is better I think the chances of getting to zero regulation, with 192 states they will never agree to all that and you got we seeing very much an environmental debate at the moment that the difference between the developed states and the developing states, there is definitely a difference and they believe there is different ways of treating each other, so I think the chances of getting a zero, probably not in my lifetime, maybe yours. But I think the idea, the framework is there to say liberalisation if you look at all the papers on the ICAO website, all the discussions that happen in the assembly with liberalisation, there are a lot of case studies, like Chile is an example and LAN model in South America is a beautiful model of a continent that said look here we can't get it right with our own state airlines, so the LAN model goes through, they have pushed forward hugely for liberalisation complete liberalisation and removing all the restrictions of ownership and control. It’s probably going to work in South America, I can’t see it working in Europe all that well, even though they got their EU horizontal agreement, and the US will protect.

If we can just for a moment separate the two parts, ownership and bilaterals, which do you believe has the greatest impact requiring a revision from an industry point of view, rather than from a specific airline or passenger welfare point of view?

They are both quite important, the issue is that they always say, just take ownership if you take ICAO will always say look you can liberalise ownership and control but they will always say it is up to the state, so you can never force a state to go that way. If the state and there was one or two carriers in the mid-90s when a state said we have had enough of our state-owned airline, Zambia is a case in point1995 when they decided we are going to liquidate Zambian airways and they looked for private airlines to come in. For me it is up to the state to decide, so if you want to look at ways in which you can liberalise further and try and improve the market, looking at the regulatory base and the freedoms and liberalising that is probably better because if you agree that there can be liberalised within route right basis the ownership issue is secondary, you could probably find that a... let’s not use a the South African case say an LAM Mozambique can probably if example let’s take Zambia they don't have a state airline really at the moment, that if for example suddenly find that whether it was South African or LAM that you could actually expand with those route rights, take Fastjet for example that’s a good example fastjet have this idea of a Pan Africa low-cost carrier they've gone into Zambia, and they did it in Tanzania and they became the effectively the Tanzanian airline so you didn't need an ownership issue effectively there, they allowed them to designate they didn't have to take over Air Tanzania to start operating they said we will become an Tanzania airline and put a Tanzania airline in place, owners in Tanzania and we will start flying and we will domestic routes and we will fly regional routes, they didnt have to worry about ownership and control, they kept the ownership thing and control in place substantially owned in Tanzania but they allowed them to operate domestically and into Zambia and attract the same thing and operate there, so from a liberalisation perspective I think it's probably more important to liberalise the route rights the the ownership and control issue because you can set up other airlines, without going into the ownership of a national carrier.

If we liberalise the air freedoms, to allow easier access to routes are you saying, and if we use the example of Fastjet having multiple hubs, in different countries, would that make there operations easier. In their case Lusaka and Dar es Salaam?

Yes, absolutely, on the assumption that they got the ability to use say Zambia as a base which sounds like they have, they desperate to come into South Africa, and I think they probably looking at using their experience in Tanzania and in Zambia to see if the can't establish a bona fide South African airline, South African fastest in South Africa.

How would they do that?

By distorting their ownership, because South Africa will not relent on the 75% I don't believe in the near future, so they will create a Fastjet South Africa, where the shareholding is shown to be 75% owned by South Africa and not just a shell company which is one of the reasons I think they .... I met Ed Winter the other day at a meeting and he said we watching very closely what's happened with between Silverair and Blueskyair, with the whole Flyblueskyair situation here in South African and Silverair took it on the principle exactly and the reason Fastjet was turned down in South Africa initially, they seem to have now sorted out Blueskyair, Blueskyair has always been a South African company so that's never been a problem, except when there shareholding changed with some of their South Africans that was sitting in Ireland, but I think hopefully they have sorted that out because it would be subject to legal challenge. Be interesting to see how Fastjet if they are happy with putting a franchise type operation in South Africa but it's run very much like a South African operation. 50% to be a Fastjet operation, operated by South African airline, it's almost like the British Airways Silverair situation.

Would that not be easier to get around if they relaxed the ownership, why is the South African state so set on the 75% local ownership for international?

I don't think we got.... I don't think we have broken the back of understanding the impact that it would have if we did relax the ownership, because even the South African airlines the successful privately airlines like Silverair and RegionAir you have spoken to them, they want that ownership to remain, I don't believe they would want it to go. Because they also realise that you can have the pariahs coming in and guys not even the Fastjets, but other guys coming in and setting up operation, stuffing up the market completely, and then not making it work in and then going out. When I've had this view South Africa is probably since deregulation of the domestic industry there has properly been about 10 or 11 airlines that have come in and gone out, and every time for me it's been a real Catch-22 situation come in like a 1time or a Phoenix or whoever, and they come in and they they offer the low fares and so everybody says great, the airlines that they competing with like the BLUE DIAMOND AIR's or the Silverair's even react, so they drop the fares so therefor the people start migrating back, so then the smaller airlines and the newer airlines start to suffer and eventually they go out of business and then they blame and say it's subsidisation by the state or the airline, but what did they expect to have to come into the market after the R500 or the R600 fares and BLUE DIAMOND AIR just continues to offer R1500 and R2000 and not to react, come on guys when you come into the market I say now Blueskyair don't complain about state subsidisation because that's the way it is and how they operate, Silverair is also going to protect their market, they not just going to sit there and allow you to come in and say I am the true low-cost carrier, they going to react as well, they very clever and true business people. So we know the environment would have operating in here now, and we seen it before and how the market in South Africa is requests we have 10 South African carriers that we work with. You have Blueskyair coming in now operating, you got skywise that wants to come in, you got Fastjet coming in, there is not space for those three airlines, all three airlines, there is maybe space for one more and we will see how Blueskyair starts and how they will go. I know it's a free market situation, a question I'm worried about is the sustainability of the industry and if you open ownership and control you could have bunches of guys coming in, you could have Emirates coming in and operating the model.

On the point of Emirates, could it not be argued that for instance my personal opinion is that for example RegionAir has differentiated service, they not competing on price, and I think they have a strong business model..

they have a very sharp operation

They make really good financial sense, if the law had to be amended, currently with a 25% stake they can't go and pitch themselves for selling on a liquidity basis to an Emirates it's not enough of a business case to go to them, but at say a 49% it might be and that could potentially grow their business massively, so I think the issue there is, the second stage they would be worried Emirates would destroy the market, and swallow them, so is perhaps the ownership stance not perhaps something that can be looked at if you put other checks and balances in, so a foreign carrier could come in and buy, based on the assurance to maintain local employment and guarantee to operate existing routes for ten years and developed so many routes per year, is ownership the best way to look at it, it could be constraining the industry too, because you can develop the industry, we say South Africa is a small market but is it truly developed?

No it isnt.

It could be constrained that potential could remain locked because of the ownership. I don't know if South Africans with money here could develop that, without foreign help?

Well let's look at one example that tried to get off the ground, maybe it's business model was flawed, and that was Sentaco, It was trying to really open up, it would have had a really a good opportunity to tap markets that were not, I remember having a chat to somebody at Acsa about 10 years ago and saying just think of the inherent potential which you talking about with they guys that have contributed to like stockvel, and these guys have huge money in the black market, all tied up in stockvel, how do these guys travel? they get into a taxi and drive from Port Elizabeth to Johannesburg they will not fly Joburg Port Elizabeth, they will drive ten hours in a taxi and yet they got money to be able to fly, but they don't do it, how do you get them into the market? Santaco had the idea, Lanseria, Bisho, Umtata that sort of idea, and there was big hype getting them going and they started the process but they probably didn't have guys looking at it that understood the aviation model very well, and they came up with a thing and they said okay we have an aircraft, we have to pay for this aircraft, we have to pay for crew, or we will probably lease at the moment so we get an ACMI type lease from somebody, and then we have to pay for fuel and we have to pay for landing, and flight charges and so X amount is how much it is going to cost us for these flights divided by X amount of passengers equals so much of a fare. And something went wrong in that model and they realised then they went out to the market and they said okay we can do it for R500 one way or R600 whatever the number was, and the day that they made the announcement that they had the big hype, I remember the CEO saying, making a statement which killed that entire project, he said we very keen but we going to the government to ask how they going to support us, and I said you have just blown it because there is no ways that any South African airline including the state owned airline will say am you can be subsidised because that is what you asking for, you actually asking for subsidisation which is blatantly different from say what the BLUE DIAMOND AIR is doing with the guarantees, you actually asking for money to be put in, to keep your operation and that was it they never flew.

Why do you think South Africa when we talk route development, low cost is always spoken of as the differentiator is there no other differentiator?

You see in South Africa when we talk about the low cost it's really Mango and Kulala and obviously you got fly Blueskyair coming in, one thing the numbers do show...

Well don't forget 1time, Nationwide, Velvet were low cost carriers, the only one to try something different was Sunair, the rest have all been low cost

driven. With it failing is it not a case of 'doing the same thing and hoping for a different result every time'?

Ya, you see the biggest problem in South Africa, if you ... the biggest thing that happened here, you had the traditional legacy carriers flying the operations, then Silverair came in and started Kulala, and they offered the low cost, but all these low-cost carriers started on the traditional trunk routes, Joburg-Cape Town, Joburg Durban, the triangle, and they thought thats the way to do it. When Kulula came in and started, and they started with their brand, they definitely attracted new market that was 2001, and then you had 1Time that started in 2004 and they built it, so there is no doubt that 1Time and Kulala grew the market substantially, there is no question about, and then the problem came that all the other airlines suddenly realised they growing the market we want a part of this market so the BLUE DIAMOND AIR coming in, and that's when they brought in Mango as well, their direct subsidiary to say we want a part of this market we can't just let everybody go because I think my understanding is now that the low-cost environment the low-cost carriers currently about 40% of the market, if you take the Kulula's and Mango's and well 1Time at the time was about 40% of the market. But now at that turned into not as much a low-cost model it's a hybrid type model.

Do you think the 1Times fails because they shift from a low cost model, to something and more?

It's a difficult one in terms of 1Time, I think what happened with 1Time is that they started operating from a very very low cost base and then all of a sudden I think there cost base grew to much so they actually messed it up with regards to some of their overheads, they had a very top heavy structure, you had the guy running it and then you had all the different airline, you had all their different things. When Blackie Khumalo came in who took away the entire top level, so he said everybody can report through to the CEO he tried to get it, but by that stage the damage had been done. There other problem was that they didn't take the option of the new aircraft early enough, I remember talking at one stage, one of the aircraft manufacturers no name came and said I have got a sweet deal for you because one of ther airlines in Europe doesnt want these aircraft, take them low cost, in terms of operating, low fuel, it was the whole easyjet option that didnt come in and these guys walked away from the deal. Airbus showed that it would, so they kept with their guzzlers, the fuel prices sitting at $120 a barrel and it killed them, so it wasn't even the marketing side of it, people, there cost just overtook them completely and they lost the opportunity.

Are you introducing that perhaps a lot of the constraints of the business are facing, is not regulatory based but perhaps access to finance, fear of finance?

And an inability to actually understand exactly what makes up their cost base of their airline, and so those guys their maintenance cost must've been huge on the 1Time aircraft, maybe the ownership cost was low, but the maintenance, the fuel double double I can almost double the amount of fuel.

So it's better to have a financed asset rather than sustaining high operating cost.

I don't have any insights into the books of Kulula vs Silverair, but Kulula is taking all the new aircraft. Ya the 1Time model is very sad, it's very sad that they left, and obviously there was a lot of boardroom battles that went there and a whole lot of things that went wrong there but I never understood why they could not. I remember the 1Time the one guy their FD told me, remember when everybody lost heaps on the hedging when the oil price went, and 1Time was sat there very smug and said we didn't hedge, so it went up we had suffered when it went up to the 148 and in then it crashed all the way back down to I think 60. He said we smiling so they thought, and they thought and I don't know if at that point when it crashed thought, we don't need the new aircraft, and then of course it climbed straight up from 80 to 100 dollars... exactly and that is where I think they stuffed it up completely, personal opinion.

If we look at ownership, and you said earlier BLUE DIAMOND AIR has got to respond and lower fares earlier.

Well they revenue manage it accordingly and put it out there.

Sure, if I break this question into three parts, first question is do you think there is a state owned airline in South Africa?

Personal opinion, at the moment still yes, because I don't think at the moment there is anybody else that could satisfy the market.

Domestic and regional market or Long Haul market?

You know BLUE DIAMOND AIR is such a difficult case, I think that their is a case for state owned because you've got successful state-owned airline such as Singapore airlines, Emirates and all that, there is a case for state owned airlines, the problem and it's one of my biggest bugbears I remember going to a conference in Abu Dhabi and James Hogan CEO of Etihad, was the speaker and he said to me let me tell you, six years into office and we are now profitable for the first year and he said the secret to this is as follows: I have got 100% support from my government in terms of alignment of strategy, which way the UAE or Abu Dhabi is going. Tourism supports me, trade supports me, my transport department supports me, everybody supports me and we are focused on becoming a very successful airline and this is the strategy XXX.

That would be the all of state model?

Yes, they are a state model, but then what he's gone and done now because it is 100percent owned by the Abu Dhabi state.

But all the departments are in unison, no opposing department of tourism, that's putting different rules and regulations.

No no, they all aligned and he said the other thing about the success is we are in the gulf here, there are 3 airlines we compete like mad, Emirates ourselves and Qatar, we are very competitive and we don't take prisoners BUT we got one aligned goal and that is to be the most successful hub in the world, and in fact he made a comment "we want the UAE to be larger than China market in terms of numbers that is our goal and we working together on that, we are competing but we working together, we don't have that situation in South Africa we have a situation where you've got a state-owned airline this is having a very tough time, gone through multiple leadership changes and things like that, strategies which I don't even know if there is full buy in, and there other airlines around the region like probably Ethiopian which is always spoken about as a successful state-owned airline but also has alignment from it’s whole government, it doesn't have competitors in it’s market, thats important, same thing possibly with Air Mauritius which seems to be doing a whole lot better as well in the region. Ethiopian has a good working relationship with the ministry and they have guys who they trust with the strategy, South Africa we don't have guys that trust BLUE DIAMOND AIR with the strategy so you have such involvement from the DPE side, you have got problems on the board, the ministers are very involved, and you've got tourism department that is saying open everything up, you got the transport minister.

They want the airlift?

Yes they want the airlift, we can show that the airlift is not a problem in South Africa, there is actually plenty of capacity, plenty and so I said at a meeting the other day "don't come and start saying that BLUE DIAMOND AIR... if you can allow Emirates to have four frequencies a day into Johannesburg, two into Cape Town, two into Durban and they pretty much allowing that to happen, you trying to tell me South Africa's constraining international, there is hundreds of available frequencies out of the UK, hundreds is wrong, but there is probably 50% capacity out of the UK, there more capacity out of Germany, there is capacity out of everywhere, and the guys even the international airlines are not flying it, so don't talk to me about South Africa being constrained. And then you got this thing like the home affairs issue, you talk about... are these guys aligned, they are not on the same page, now they have gone and deferred it, we were quite involved in that, but they have gone and deferred it, but the damage is done, there is a lot of damage done.

You say Emirates 4-2-2, that’s effectively going to happen, they saying that is as far as they are going to allow it, but have they thought about seat occupancies, because Emirates is one airline that as Toulouse starts delivering that is going to be able to switch on to A380's that although it’s only eight frequencies, it could effectively become sixteen because you

just doubling seat capacity with the larger planes, and they got the ability with another 92 A380's on order.

And it's now been shown that is that you can do the numbers that even with the triple sevens that they flying there seat capacity is higher than the seat capacity for Blue Diamond air.

Apparently their break-even point is around 70% occupancy, which isn’t that high.

No it’s incredible

Going back to the state owned airline, if there is a need for a state owned airline, do you think it could be a case of the South African government, the Beijing route is often used as example, with the planes flying empty, do you think perhaps government does have a bona fide reason to link to China, including political reasons. A lot of South Africans disagree and claim there is no need for a state owned airline, could it be a case that in South Africa no private corporation locally that could provide long haul connectivity with Johannesburg as a hub, like BLUE DIAMOND AIR. Do you think it would be a lot more palatable to the public and industry if BLUE DIAMOND AIR, got rid of their narrow body fleet and operated wide body long haul only, and then in the daytime when the planes are back in Joburg, offer the connectivity from Cape Town, Durban, PE but on a smaller scale as an interface to their long haul. So in other words they flying domestically only as a connector to fill their inbound and outbound long haul, and not competing with the private commerical carriers like Silverair, Flyblueskyair etc. That will reduce available capacity which will disable non sustainable behaviour. I am sure they will only then sell K buckets only and no more of the super discounted G Buckets being sold. There will then be no need for a new carrier like Blueskyair to offer unsustainable fares simply to enter the market? The consumer will not pay more if they are connecting though because in such instances the fare includes the domestic portion built in to the price of the international sector. And likewise if someone is adamant to fly BLUE DIAMOND AIR domestically they can, albeit at a higher cost, the beauty would be that

they would have a choice of four other carriers who will still compete in a competitive market. Would that be more palatable to the flying public and the industry, as they could no longer be accused of burning money to price out competition, and at the same time they still provide international (long-haul and regional) uplift on out terms without being reliant on foreign carriers, and at risk of them pulling it, I would assume it's prudent to have that capability and capacity under our control?

Am I hearing you say that BLUE DIAMOND AIR be turned into an international airline only instead of a domestic airline?

If you look at the Singapore and Emirates, even Cathay, that's what they do, they fly internationally long-haul, and I am suggesting they still fly locally but on a non compete basis.

What I don't understand about BLUE DIAMOND AIR at the moment and that is why I'm not sure if it will work now is the fact that their cost structures are of such a nature that they seem to be losing more money on on international routes then they are on the domestic routes and I'd you know if I sometimes and you know you travel as well, you go to New York and the sort of prices paid to New York or to the States you can't afford them so half of us are travelling, when I travel in my private capacity, I look for the best fare, and my wife checks me out, and we end up flying via Dubai or whoever, I far prefer to Joburg New York, but at that price we don't do it, I don't understand what is I'm hoping that they got their models right but at the moment they need the .... you have said domestic routes what about their regional into Africa routes which are good for them so you keep the Africa routes as well, because that's what is subsidising them too.

What I have been hearing in my own reading as a layman, a lot of their problems in parliament come up through the private carriers rallying pressure through the opposition, and I think if you took out that compete.

Silverair has always said, Erik has said often that they don't have a problem with the airline operating but he is correct in one aspect where in 1990 when they put the regulation together they said you must not allow the domestic to cross subsidise into international so he has always said I think that they should be trying to ringfence international and domestic and keeping separate books. When I was there we were trying to do that, they were trying to keep the books separately and you could monitor routes and so that only thing at the top was the overall overheads that you could not allocate and then they were very route specific and that's why they look at these individuals routes such as the Beijing's and they can see how much money they are losing per year on the ... I know their Beijing one is a disaster.

And that neednt be, perhaps with marketing more than the FlyBLUE DIAMOND AIR website, perhaps you need to, because China is such a different market, perhaps you need to appoint a Chinese business selling your airline.

They do have an office there, I would think they have a GSA as well, but to what extent... The big problem is that a lot of the Chinese traffic is Chinese labour, which is low yield stuff. I have to think about it, I come back to what I said initially, I think an airline to operate a successful international service has to have a feeder network that is really good and successful, that is one of the reasons why they put together the whole alliance between RegionAir, Express and thats got muddy as you know and BLUE DIAMOND AIR now. But the whole idea was tertiary markets, secondary markets, feeding the main hubs and BLUE DIAMOND AIR feeding from the main trunks Cape Town, Durban, Port Elizabeths and then feeding them. So to take that away I mean if you were put that into something there would have to be some sort of a guarantee that they would feed in.

But if you look at flights from PE that depart at 6:45pm they don't touch down in Joburg before 8:20pm, those are never going to feed into international. I agree they need the feed, but perhaps they need to stop competing for day travellers. Perhaps that is Blueskyairs difference, I see they targeting businessmen, by charging R150 to check in a bag, following Ryanair.

I had that first experience when I flew with my family, I had to go from Barcelona to Paris and I decided let me try this Vueling airways, Vueling is the Spanish low cost and this was an experience for me. Going on and saying this fare only cost me €50 but you want to sit with your family 20 you want to take a bag 20, it's not so cheap, and that is the way Blueskyair is going that route, we will see how the market reacts to it, could be interesting.

If I could give you a golden pen and I said for today only you can skip parliament and promulgate regulations what would you do?

Would it be domestics or anything like that? You see domestic is completely deregulated, except for the ownership issue.

Would you adjust that?

No, not at the moment, I actually don't have a problem with the 51% 49% so I could actually go 51% 49%, I still think I want the the majority owned here.

What would be your reasoning for that?

I think it would enable again you know having worked in the situation the problem is you always want this minority protection. So an investor coming in and going 49% but saying I'm coming in at 49% I would actually want more control and we know what happens sometimes, South Africans go into Africa, they go 5149 but they make sure they are in charge of the management. Minority protection. The primary reason I would go down is to enable the investment into the country.

Etihad has now gone into Darwin, Seychelles, and they have only got 25% but with the condition that they place the CEO.

That could work, I don't have a problem with the 49.

But would you insist on a South African CEO or a strong South African vote?

Yes.

So vote plus one?

Yes. Once again you ask an interesting but difficult question because your asking whether the controls are as such, so when we as South Africans go into to other parts of Africa we insist on being control, but when we ask other people to come here we still want to be in control. But I think that the interesting thing and you probably experienced it in your business environment is that the interesting thing about is that to some extent is and I acknowledged it, for me it's a policy issue that government has to make a decision. If you decide to scrap this ownership and control you must understand you not going to have a State owned airline, because i think eventually it will get swallowed up. If you get an emirates coming in and putting in a domestic carrier or a massive Fastjet operation then what'll happen is the BLUE DIAMOND AIR and I don't know to what extent other carriers like this but that is a major policy issue and a big mindset change that has to take place in South Africa.

You say you might loose the state owned carrier, to an Emirates for instance if you make these changes.

Even potentially other carriers.

Is it not a foresight into the future if we look at Qantas and Emirates, because I think essentially or eventually Emirates will own Qantas, or have a controlling stake, but I don't think they will be as audacious as to take away the red flag and the kangeroo, it will just be operated by them and they will, there will be that consolidation of perhaps the efficiencies they can yield out of that consolidation. Do we really need the control to be local, if we can still have the benefit's? I spoke to Erik and he said he has been approached by airlines for consultation purposes on how to start a national carrier coming out of civil war, why do you want to throw

money at it, and have all the risk, and have the back office, when they could run a virtual airline with shared risk for them, but he says it becomes a case of "we want our own national carrier". Does the public want a national carrier or do they want a carrier that they identify with, perhaps to their country and has the benefit's, but not the costs?

No, I think the majority of the public would say they want an airline and they don't want a national carrier. And is seen to be South African and operates well. I mean whether you call it... we know British Airways for example is not government owned and is privately owned effectively, not even UK owned and yet it's as British Airways so I think it's a mind set change, we have got to get through in South Africa, ultimately it's and I don't think the government is ready for it, they actually more in control now then they were pre 94 I can tell you know.

So can we say it's political will, it's a political issue, and it needs seismic shift because it's not business driven?

It is not a business driven operation at the moment and I think it's a lot of pride at stake here.

Real pride based in reality or based in some other .... I mean we have so many companies in South Africa that have gone into the world, look at SAB, look at Sappi, Nando's starting in a small store in Rosettenville, there is some sort of pride when you go to Canada and you see a Nandos or Australia, or in New Zealand.

We went to the Washington one, couldn't believe it, fantastic!

Do you think we could have the pride without the government interference if it was well run?

Absolutely, no doubt about it.

I know Emirates argues they a private organisation.

No they very much government owned, 100%.

Yet they do run to an agenda that's for the people of the state, but not the political.

But they have got such support it's a case of like if BLUE DIAMOND AIR was able to run, obviously because they compete, Emirates doesn't have a local airline competing with it, neither Etihad or Qatar.

Look at Singapore; they have Tiger and the others popping up. Perhaps something should be said about the geography, not the location but the actual size? Even Cathay.

Ya, you can't have a domestic market for those operation that's why they so great as hubs, but that location.

If we look at Cathay, Swire own them.

Yes also government partly owned.

Small island state, doing long-haul with no domestic, is that not an indicator for us that long-haul needs to be separated, just looking at these successful ones.

The problem is, I don't think our hub status is sufficient just with the hub status, like the Singapore's, like the Emirates at the centre of the work everything can fly via via Singapore the same situation. Us you got to come a huge way South the only real good hub, and it's something we never tapped was the East West scenario, where you could go China to Brazil. At one stage Singapore was desperate to get fifth freedom going Singapore Joburg, Joburg Sao Paulo, but South Africans were never going to give that.

The Malaysians had it?

The Malaysians had it to Buenos Aires and that was amazing that they even gave that up but they got that in the early 90's that fifth freedom right, BLUE DIAMOND AIR screamed and shouted about that.

So our geography is a constraint that we cannot escape, we can do nothing?

Even the situation, one of the the disadvantages about South Africa as well even, we're probably an hour to an hour and a half too far south office in Johannesburg I often say if Johannesburg was where Harare is, it would make a huge difference, because you cannot do a turnaround with that aircraft, because you don't have the rights to go, for instance KLM does that during the daylight, because they can come down and go back and go somewhere else, we can’t go back again, you cannot turn that aircraft around in a 24hour you cannot do a full circuit in 24hours, impossible.

Do you think that, and you brought up the Asia to South America, do you think that there is still undiscovered hubs at this point, perhaps mid pacific that could link North and South America going to either Australasia or Asia, in other words having a hub in say Guam for instance, that you could have a four way connecting in a pacific hub, is that perhaps not exploited.

You don't need a hub with a long long-range of these aircraft they don't need to go via.

Well currently there is not much traffic from let’s say Sydney to Sao Paulo, there is no connection in fact, if you had to hub there, it would be a hub where Emirates just could not compete. They would be on the wrong side of the world, it’s probably the only place they have poor geography. If this is the case, is it regulation holding these sort of connections as well.

Interesting. Another good reason why I am not sure that that would work compared to like Singapore and or Emirates. Emirates is very close to Europe, a couple of hours away. Singapore is close to Asia. This place my understanding is, would be a long way away from anywhere. You don't have fleet utilisation, and no ability to have short hops, for instance UAE is huge into India, Bangladesh. Singapore is huge into Malaysia into China, into Thailand, so they also have the domestic market, which is like their regional market effectively.

Geography plays a part?

Yes, that's one of the big reasons why in South Africa we very concerned that we made life difficult for people to come here because the fantastic hub status of OR Tambo is actually being, to some extent dissipated.

So Johannesburg is only a hub into regional Africa? Feeding long haul to Joburg and regional out?

Ya, I think some of the guys are reasonably annoyed with the transit visa situation. The fact that Emirates is now flying to more destinations in Africa than Blue Diamond air, they fly 23 or 24 destinations now, and when they came direct into Harare, even though they do the Lusaka leg. And they probably got fifth freedom.

They do.

Ya, exactly I don't think BLUE DIAMOND AIR has a fifth freedom right sitting in Africa at all.

They use some of the points in the Yamoussoukro agreement as basis, to argue it, so it benefitted Emirates more than African carriers.

But Yamoussoukro doesn't apply to Emirates?

They justified their case with the arguments of access in Yamoussoukro to justify their case. Do you think Emirates will take over regional routes

in Zimbabwe, Zambia and Malawi. If they flying daily, do the people need an unreliable Air Zimbabwe?

I'm amazed what Zimbabwe has done, because their carrier went through a very tough time, they got a new CEO now or he is an acting CEO, I was up at the group's conference that took place in Vic falls they were very bullish about increasing and opening the doors again for tourism, he is a very learned guy this Edward Mokane, his the new acting CEO, his got facts and figures at his fingertips, I can't believe he can just talk like this. But they have gone the route now saying they going to support their carrier coming back in, but then they have also allowed Flyafrica to come in and that's a Zimbabwean airline flying one of the premiere routes, Vic Falls to Johannesburg, I think to myself what does Air Zimbabwe say about that, maybe the decision was made while Air Zimbabwe was in trouble, now there are up and running they got the two guys, at one stage when they had their problem with their pilots and things like that, I thought that was the way the Zimbabwean government was going to use to get them out of the market because Air Zimbabwe, but they didnt, so they still operating. Because Flyafrica has got the same idea as Fastjet.

Multihub? Is there room for BLUE DIAMOND AIR to have a multi hub in West Africa?

That was one of my last projects I ever worked on was to get three hubs process going, my last job was Alliance Air, do you remember the Airline SA Alliance Air?

No.

It was a joint-venture operation between South Africa through Transnet - Ugandan government and Tanzanian government we fly Johannesburg Dar es Salaam Entebbe London and back. The intention was to purchase Uganda Airlines and Air Tanzania, a set up the feeder network, but through shareholder differences we had to close the whole airline down.

Again political will?

Well it was political will, there was political will from South Africa with initially the Uganda and Tanzania governments were very supportive because this airline started in 1995, and eventually I had to go and close it down, well I was there for two years, and the time we were there we were trying to purchase Uganda Airlines which was technically a liquidated airline so you trying to buy a paper airline, but they wanted a lot more for it and Air Tanzania went the same route, but there was that that idea, was to have, to maybe create a hub in... it would have been a very difficult one because it would have probably been Entebbe which was only an hour away from Nairobi, which is a very strong east African hub and then intention was to have a hub in West Africa, whether that be Lagos or Abidjan or Accra or even Dakar, we hadn't got that far, but that thing.... So yes the idea would've been there...

Ever going to happen, or political will still?

I think political will still. You know the thing is guys like Ethiopian seem to be doing it, whether it's going to be a successful one because of the hubs they have chosen I don't? They obviously got Addis their strong hub, they've got Lilongwe through the stake they have taken in Malawi airlines and then they got this ASky in Lome Togo, those are not great hubs by they punting them as hubs, so they are using them as trunk routes and then taking say from Lome into the region. Malawi, trying to get Malawi airlines going again.

Although Emirates is moved into Malawi.

Yes. Ethiopian as well, it's nice for competition.

In terms of protecting the market, what about a strong African carrier like Air Mauritius, who are doing relatively well, how do they stop the likes of Emirates? Emirates have announced by year-end they will be flying double daily A380 to Mauritius.

They have gone into a very good deal with Emirates, a really good code share deal.

If you can't beat them, join them?

That was one of the things I had to do, BLUE DIAMOND AIR were still flying to the Emirates, and eventually we realised that the problem was you were never going to compete with the product they were putting and the pricing, and that was the whole idea of that codeshare arrangement. Air Mauritius even though they have a good product flying, Emirates with these big A380's coming in, double dailies, I think they negotiated a very sweet deal with Emirates, and said let's work together on this route.

Like Qantas has done?

Ya, and thats probably what they going to do. I actually asked them how is it going and they said no it's working well.

What is the carrot for them to get into deal?

So that they they don't have the operating cost environment, so they basically pay Emirates a certain seat price and whatever they sell, they've probably got open inventory access.

So it's pure profit?

It's profit making money and paying them a certain price, Emirates probably thinks it's good to have the Mauritian locals to support them. Part of the global carrier goal.

Do you think Emirates will eventually become the world's global carrier?

I think you will end up with a couple of global carriers, probably become one, it will be interesting to see what Etihad and Qatar has a view. It would be interesting to see if they don't self implode on one another.

They will be the global carrier, excluding Europe and the States, as they putting their foot down hard.

I think the East will also soon put the breaks on.

They havent to date?

Not that I am aware of, China may start to think "no no".

I see they flying Rome and then on to New York as well.

Because Alitalia is so weak.

So there is a case to not allow your nations airlines to get too weak, because that's when the predatory starts, so there is an argument for the state to protect. But why not allow Emirates to just take over? Would that be a bad thing?

For the customer probably not, they couldn't care less. I think if BLUE DIAMOND AIR disappeared there would be a bit of a state pride issue, and for us in the industry and it would probably be a knock. From a business perspective our competitors would say who cares? They have drained the country too much already.

Would they leave the vacuum?

Yes

How quickly could that be filled, and who would fill it.

Well that was one of the questions we asked, I even mentioned to Erik once, I said to Erik once "if BLUE DIAMOND AIR was suddenly pulled what would you guys do?" He said we would never fill the gap that quickly, we'd obvioulsy expand quite considerably and they would do damn well, because they run a heck of a good operation. There would be a vacuum but it will fill. You would probably find on all international flights you would have airlines increasing frequencies into South Africa, the BA's, Virgins, Lufthansa all increasing frequencies.

What about South America, North America.

South America you'd probably find some way that South America you mean from here into South America? North America Delta would keep going you may even find United start flying, because they can do long haul, South America would be an interesting one whether the LAN crowd would start to fly. So I think the gap would be a hiatus of time, but I think it will fill, six months.

Going into the ownership variable, we spoke of manipulation going on with Fastjet looking for a local operation, have the alliances been a manipulation too? Trying to get the globalisation agenda using local carriers? Fastjet SA would be managed by Fastjet as a subsidiary beneath, but owned 75% by South African hands. We saw with the global alliances, it didn't amount to true consolidation, although alliances did deliver some benefit to the industry and the consumer, in terms of connectivity, interlining, and shared frequent flyer benefit's, but the true efficiencies in terms of cost, having these individual organisations you never got true consolidation.

Yes, but only in some areas but not to that extent where you had the airline lounges in foreign places and the problem I think has been a huge issue related to competitiveness. Because things are happening in other parts of Africa we don't have competition regulation, which happen elsewhere and we asked why we don't do that in South Africa, because in SA if I suggest a joint fuel purchasing agreement you would have me in the courts, South Africa is no ways that would happen, yet it does happen in other parts of the world.

But if you merge the companies into one true company, you wouldn't have such issues, so perhaps ownership does have a cost point of view.

Would you say it's fair to say customer welfare would be improved if current airlines could be consolidated?

The big issue here and it comes down to South Africa is that if you were to do that, operating cost wise the guys may have certain margins to improve on, fuel would be debatable and that's a major cost, the question comes down to, if that consolidation were to happen what would happen your idea would be then to consulate on human capital and reduce human capital to some extent, South Africa there is just no ways, and that is one of BLUE DIAMOND AIR battles that they are not allowed to shed the excess bodies they got and that's where a government policy, talk about a turn around strategy and the strategy probably says get rid of 2000 to 3000 people that's what we actually need to do we are not allowed to do that, so in many cases it's like what happened when Air France KLM went through that process, when they consolidated it was a lot of pain I understand for some of those guys I understand a lot of people were either redeployed or lost their jobs.

All those consolidations were all in Europe, Lufthansa with Swiss, Air Dolimiti, Berlin, CONSORTIUM A BA, Iberia, although CONSORTIUM A says they would love an American airline, but can't.

A lot has to do with government policies.

There always has to be winners and losers, so if the loser is the excess heads that are lost, who are the winners?

The consumer.

Who has got the upper hand to make such arguments, is it an impossible balancing trick, why let millions of consumers loose to protect a few excess heads.

Yes it is. For the state, BLUE DIAMOND AIR went through three retrenchment exercises, they retrench, creep, retrench, creep and now they at the point that they should probably be doing that again.

It’s the wrong people?

Yes, yes loosing a lot of their best and experienced.

Last point, whilst we have been chatting have you been saying to yourself "I wish he would ask me about something I haven’t asked"?

No, what you have actually made me start to do here is actually, to start moving outside of the paradigm due to the thought processes we have been going through, because we talk about my mandate from this association is to ensure the sustainability of the airline industry in this country, I sit with the BLUE DIAMOND AIR guys, the Silverairs, and RegionAirs, and the expresses, the mangos, and obviously my regional members as well, and it is always an interesting thing that the guys will be huge competitors, they also want rights, but there is also obviously they're always watching what BLUE DIAMOND AIR is doing and very concerned about what is happening especially these guarantees continually and they challenge them in parliament as well. The question is and I said it to a couple of people we are actually constrained by potentially the hold the government does have on the industry, and it’s control it has, particularly on the national carrier, and thats why I am saying this personally, probably ultimately the best route would be to allow to go the privatisation route, because I don't know if under a current state-run organisation we will ever get it out of this, when they said we got a 20 year turnaround strategy, I said I can’t see how you can take 20 years to sort this airline out? What will take 20 years? Why does it take 20 years, and the 20 years I think is the fact that you almost got the situation where you got a certain workforce here, we know that we actually should be getting rid of them, so we wont take in anybody else new, and it will take us through growth until such time as we get the right level. The more I think of it the more I sigh

Replace political will with business will?

Absolutely, and I wish they would allow that to happen, but you've had to the last couple of years such state control of this thing it’s ...... my understanding and my view is that I hear on some of the discussions, if they make a decision, it's government thats making the decision, they may make recommendations for the board, but the shareholder is making the final call, and I think, I got a guy there that I have a huge lot of respect for, he is a nice guy.

At BLUE DIAMOND AIR,

Ya the new CEO, whether he has got the whole .... he didn't bring a lot of airline business experience but he was part of the airport, he does bring some business acumen in but is he allowed to, he came in, I worry about his ability to pull this through. He is a figurehead and leader, but he relies on the CSO.

INTERVIEW ENDS

9.4.7. Transcript 7: Interview with senior consultant at Texas based airline consultancy

The airline industry is really well defined in terms of the regulatory environment, specifically ownership regulations and air freedom points or bilaterals, do you think these regulations are onerous to airlines or do they enable airlines?

I supposed it’s a bit of both, if you're an airline in certain geographical advantaged positions or you sit on top of a lucrative home market, could be advantageous to you, if you are from a small country with a small local market and perhaps not as geographically advantaged it’s very difficult for an airline to succeed, that presumes that it's in any way normal of natural for countries to have airlines in the way that they don't have any other industry, I mean most industries are quite global now, because of the ownership restrictions lots of countries still have a national airline that sort of have no business having a national airline, because their home market is small and there in the in the context of big geographic market like the US or Russia or something or even Europe where you got a single market, you have hubs that sever all the domestic markets well in that context a small country like one of the smaller European countries would naturally be a spokes rather than a hub but some of them still go on maintaining their own national airlines for reasons of tourism promotion or national pride or what have you, so I think it's advantageous for say a large US carrier not have to compete against in the domestic market against perhaps a foreign flag who could come in with a low cost structure and it's a bit of a disadvantage for a well-run in a small market to be unable to compete outside their own bilateral environment that exists now.

In terms of the two dimensions raised initially, which do you think has the greatest impact on management’s decisions? When they operate daily, what of the dimensions has greater effect? Would they rather have a free ownership environment if they were say for instance in a geographically advantaged area, or are they looking for bilaterals? What is the biggest player between the two dimensions from a management point of view?

I wanna make sure I understand the questions so, you're saying in a bilateral environment versus a cross-border ownership which would be more important to have liberalisation?

Yes.

Okay okay, so I don't sense any real push globally for cross-border ownership at this point in time, and will confess it is a bit of a mystery to me because it's a sort of logical eventual step for airlines and for those whose growth potential is limited because their home market is saturated and therefore they are really only able to grow internationally, well being able to develop a truly global network in which they operate between country B and country C instead of always touching their own country, it would be a logical thing to wish for, but I sense that there is no push for that practically whatsoever the last thing I can remember coming up along those lines was the Virgin America had to be limited in the degree of ownership from Virgin in the UK, because the US ownership imitations so I guess by definition i'm saying I think everybody wants more rights, has specific rights they are looking for, and slots which are the other side of that coin, I don't really hear anybody asking for a liberalised ownership environment.

Do you think they are not asking for it because it seems a push too far. There are some moves to consolidation in Europe now, just look at KLM Air France and CONSORTIUM A with Iberia and BA, where it was allowed they did make a move. Could it be they just don't believe the laws will relax sufficiently? Look at perhaps Qantas if the laws were to change, Emirates might make a jump at it?

So my sense is that Europe treated itselfas the single market because they found that to be advantageous in negotiating with other trans-continental sized countries like the US or ultimately China, although i think the real driver was the US when the US went the open skies push, Europe found it advantageous to be a single block I don't know whether it's a sense of a bridge too far or there are other reasons I honestly couldn't give you a lot of insights into that, because it is completely absent from conversations I am apart of about the industry and by that I do mean even things I read in the trade press, it just does not seem to be an issue. I think our alliances, global alliances are a convenient proxy for cross-border ownership in the meantime, and it has a long way to develop for there the seamless experience that the members tried to promote, perhaps one day down the road it's the precursor to cross-border ownership.

Do you think the global alliances, when you mentioned a proxy, they the second best play that an airline has when facing ownership regulations in that is the only option available to them? Because although alliances have facilitated the JV's, the code sharing, a level of frequent flyer benefit's, there hasn't really been true consolidation in terms of buying power and fleet utilisation, it almost seemed like a second best alternative. My question therefore is do you think they will evolve, or are they just a placeholder as to what best is available now?

I think both are possible it's definitely a placeholder for best available right now you get some of the benefit's, clearly not all of them but i do think they will evolve continue to evolve in that direction, it's not going very fast some of the obvious stuff I guess has been done in terms of the joint ventures that you mentioned on selected geography where they overlap, but to your point about fleet, everybody wants they want in the very specific as to their individual requirements. I remember boeing made a move some years ago to see if they can make planes cheaper by offering much more standardised service configurations and not letting everybody's aeroplanes be quite so customising and there was absolutely no interest in that from the carriers.

Right, with the current situation of the bilaterals, that they are too constrained, and it should be more open skies, as in the transatlantic, which isn't quite a true open skies it is a step closer to what we have in Africa.

It's a question I guess as to what you value, from a free trade minded person and a consumer benefit's person an open skies is pretty clearly a good thing, it does, it can be threatening I suppose to you mentioned Africa for example so the African aviation environment is weak compared to the competitors from off the continent, the brands are not well known, and not so competitive with the European carriers, and it's a little bit like the Caribbean, within the Caribbean you have carriers .... individuals travel to Miami to get around the Caribbean which is way out of their way, you sometimes see the same thing with people travelling from one point in Africa to another via Europe's which makes no sense at all from a security standpoint, but I think there is a reluctance to embrace open skies on in the case of countries who think their national carrier may be threatened by such a thing.

That leads quite nicely, do you think there is still place for a national carrier? Chicago 44 spoke of it being a key strategic asset post war, does that still hold true, I know the law is still valid, in reality.....

It’s another opinion question, your opinion might vary depending on where you live you could ask me my personal opinion I suppose I'll take a in industry view of it and tell you, if I'm the US where the civilian fleet is theoretically on call for deployment of troops in a time of war I don't see the US ever allowing all of it’s aviation capacity to be foreign owned, so it is a strategic asset but the US is one of relatively few countries that's in the business of projecting military force around the world on that sort of scale. Another view of it is if I was a Caribbean island or another country heavily reliant on tourism in my GDP I might consider having an airline to be a loss leader it does not have to operate at profit to be net beneficial to my GDP if it brings more tourists to my country than would otherwise come based on what other carriers which choose to offer to my country. So you could use it as an economic development and tourism delivery tool I think a positive basis for the economy overall but those cases are probably relatively few and far between and there is a lot of people maintaining airlines of larger size than they need to be for the size of their local demand, base on the hope that it's providing economic development, but I think he number of cases were this is possible for that to be true is certainly greater than zero.

Would you say that’s the case for Emirates, all the Middle Eastern countries, and Singapore, small country... ?

So Singapore is a very special case it's an extremely lucrative local market and I think Singapore airlines has been quite successful there, and by being able to be profitable in a city state I'm sure they enjoy more service and a kind of hub status that they wouldn't have if they were a spoke on everybody else's network. Theirs is viable though because it is such a heavily premium travel market unlike the cases I was mentioning, tourism development in their case it a heavy degree of premium business traffic that supports their airline. You mentioned emirates so that is a bit of puzzle there, whether they are ... it's difficult to be profitable on a market that is so heavily reliant on connecting traffic. They do occupy a interesting geographic niche in terms of the connecting potential from the East to the West, I did see some analysis that suggested that there are published results are potentially quite doable without subsidy the sort of thing you hear bandied about regarding them, because one end of everyone of their flights touches the Emirates which is a very low-cost environment, and they have a fleet that's very efficient it's all brand-new, quite fuel-efficient and there average length of haul is quite long, all wide bodied fleet on long-haul is quite efficient.

Emirates being a new fleet, their sectors typically longer, do you think we need a separate regulatory framework for domestic regional versus the long haul carriers? Is it a case of one size doesn't fit all? Is the long haul that different, that they could operate in a free environment. The regional markets in Southern Africa for instance seem to be reliant on protectionism.

Yeah it's an interesting question and never really been asked that or thought about that before, so i don't consequently have a ready-made opinion on it, let me think out loud for a moment, so that sort of idea I guess allows for the protection of small market carriers who want to continue to be able to compete for as a regional entity while allowing a freer environment for the long-haul carriers.

The argument made locally is our markets aren't mature enough.

Yeah but if you asked that question 20 years ago Emirates wouldn't really been on the radar to to the extent they are now, the growth rate that has surprised everyone but them has put them in the conversation as been one of those long-haul carriers so I guess i'm just saying things can change a bit faster than maybe we anticipate so it's conceivable there are some markets that might say hey I want to protect my little regional position right now, they might be showing differently about it in 20 years time I guess that's a long time, but things move pretty slowly in the aviation regulatory environment.

They do, one of the issues that is often brought up, is geographic advantage. That is something airline management cannot change. Is the industry turning to a point where that is one of the hurdles that can't be overcome, and if so is there another spot like the Middle East?

So it is a hurdle that the people of earth live where they live, and the cities with the sufficient local market size to support a hub being there, you would never put a hub in an empty space, yes there are certain cities London Dubai New York that happened to be big cities that also in good places to direct traffic onwards, Tokyo many of them also have a nearby competitor Dubai has Abu Dhabi, London has Amsterdam, Frankfurt Paris. New york has two airports even within the city other jumper off points like Atlanta. I would answer by saying decent sized population centres that are behind the likes of the western carriers that are already big, and the Middle Eastern carriers there are big and growing really fast there are three right there in the gulf, there are others like Aeroflot that is also in pretty good geographic position for east-west flows, rather more northerly but it is a competitor for many east-west flows also, it's relatively they been growing very fast but it is considerable behind the growth rate of an Emirates. Turkish is a little behind the the gulf carriers, but is in a similarly good geographic position and Istanbul is obviously a big market so I would say the Moscow's and Istanbul's are just kind of the Doha's and Dubai's of tomorrow they are not so far behind. The ones after the day after tomorrow I don't know but there are certainly other places on the globe that are growing very fast and will become more significant markets and they are now no doubt, China has some of those with the number of interior cities they have that are already large and growing very fast, those will become destinations for long-haul carriers and they may become significant domestic connecting hubs.

Are there any on the African continent? That could be, but aren't at the moment? I know there aren't really any right now, but could there be places that could become?

So that the difficulty with Africa in terms of hubbing is that most of the biggest markets today around the edges of the continent, in South Africa, Egypt, in Nigeria and so you wouldn't fly necessarily from Kenya to Ethiopia by way of one of those places, the middle parts of the continent is a bit behind in terms of that potential I think, I think by the time you factor in the biggest markets on the edges the overall size of the African market is quite small, but it's those edge carriers I guess that have the biggest potential to become the carriers that hub traffic between Africa and points off the continent. South Africa least so, because there are at the southern end and not really good position to carry very many people from Africa to anywhere else that isn't kinda of circuitous, Lagos and Cairo our economically and politically today not enough and stable a situation that seems likely for them to become global aviation and commerce hubs, Ethiopia is a big market and not a very lucrative one from a business travel standpoint which is kind of necessity to grow beyond a certain point. I just recently completed an African market study, there are plenty of other markets that have a good traffic base and growing fast but it's a base thats quite small and difficult to see which of those might be even an intra-African hub any time soon.

You brought up an interesting point now, you said that the business in Addis is missing, it’s not a business hub, but geographically it’s great. Are you therefore saying that Geography is just one of many pillars, and a whole picture is much more important, than just geography.

That's right, so long haul operations call it a rule of thumb that you wan half the revenue on board in the premium cabins, and and you can make the market size anything you want by offering a sufficiently low, you can stimulate traffic to fill up any plane to a 70+ percent load factor, but that won't be profitable you have got to have a certain fraction of the aeroplane full of people paying premium cabin fares, full coach fares, that's where I think Ethiopia is not a big market, with 80 people I think in Ethiopia. It doesn't currently support the heavy volume of business traffic relative to it’s visit friends and relatives traffic that this is quite well developed.

If you operate as a hub, and you need that premium high revenue fares, airlines cannot make a city/country business friendly, could they rather

make their hard product sufficiently comfortable to attract people that way? If we continue on the Addis - Ethiopian case, perhaps India to the US East Coast, trying to improve the hard product to make it attractive to the premium travellers?

Meaning the on-board seat and service?

Yes, Emirates has done this well, in terms of business and first class cabins, their A380 is still the only passenger commercial planes flying with showers.

My view on that is for a business traveller, typically time sensitivity is a major determinant, and are typically people who are globetrotting also have an entrenched loyalties to one of the other loyalty programs or alliances. They will you use product as maybe a tiebreaker or maybe they will even steer themselves towards are Emirates, Singapore or Etihad for reasons of curiosity about the fabulous things they heard about showers on board and apartments and so on, but I think that's fairly marginal you not going to fly 20% extra mileage to experience that sort of product, just my view.

So the premium passengers, they still looking point to point, rather than hub ideally?

So if you offer a premium traveller coach non-stop versus business class connecting, I think they will go by length of haul to determine their option, and degree of seniority, and the imperative of being by particular time, but let’s say two very long hauls, with two connecting itineraries, I can see them going a little bit out of the way to take a carrier with a a repetition for an outstanding product, but I through 20% as the excess mileage that it’s strikes me as about the threshold where that begins to fall off dramatically. That would be §on a long haul, on domestic short haul nobody wants to go 20% another way.

You deal with airlines and you often face I suppose a lot of challenges in what you can advise in terms of direction to the airlines, your customers, if I was to give you a golden pen and say, you are a lawmaker today, and

you can change rules and regulations to make your job easier, what are the things you would like to do?

I'm struggling with that one because the regulations are a given constraint throughout my career and they don't particularly make my job more difficult in some sense they support my job I suppose, helping carriers navigate the implications of those constraints on them are and formulating a strategy based on those. If I would answer again from the context of what is best for the travelling public, then short of firm cross-border ownership and then I suppose the proliferation of open skies and alliance development is a benefit to passengers but regulation doesn't make my job per se more difficult.

If you don't favour the travelling public, but perhaps favouring your customers?

So depends on the customer, I work for airlines in different geographical locations with different business models and different market positions,I cannot uniformly answer that any law would be beneficial to all of them because some of them are in that sort of large geographically advantaged position, and some of them are quite small and quite vulnerable, so they want different things.

Let me put it this way instead, each airlines circumstances are different, but from an industry point of view generally speaking?

Well I will have to answer it a little bit more anecdotal perspective than anything else I suppose, it depends on where they sit, what their particular set of issues are, and what they want, so just thinking off the top of my head if you're CONSORTIUM A. you are already in Heathrow with a advantage slot position, so BA dragged it’s feet for years on liberalising Heathrow access for the many US carriers that didn't have it, and that was the right commercial decision for them. If you were in STAR or Skyteam during that same time the UK to US market was a key trans Atlantic market, and for the us side of the equation getting access for Delta, northwest or Continental into Heathrow was top your agenda. Slots are is one thing that is pretty uniform across the carriers that they all want access to slots. Tokyo Narita used to be a huge slot game that no longer is because of the opening of Haneda and the increasing over flight over Japan to Korea or China, so Narita isn't what it used to be with Haneda opening that isn't quite so important, but everybody has got slot needs and the slot market is a bit murky theoretically they not bought and sold but they in fact are, value changes hands for them all of the time, that's not regulatory per se other there is governing regime in place in each market for slots that the carriers have to live with.

You have introduced a new lever, even with complete liberalisation of the Bilaterals, the slots could become the next constraint.

And they already are, access is free but slots are a practical reality that still limit your ability to operate.

The airline industry is growing, so this constraint will develop and grow, because you now have a physical limitation limiting the number of movements.

Yeah and not all slots are created equal, obviously there are peak times that are much more commercially desirable than others, and those slots can be extremely difficult to secure. The other thing is you mention airlines are growing and that pressure will continue, there's a couple of ways that can play out, Airbus and Boeing made fundamentally different bets on that Airbus bet that the A380 was a good idea because A) if you've only got one Heathrow slot a day, you going to want to push as many people through that slot as you can, so you want the biggest possible airplane, I think Boeing looked at the same world and said that from a passenger standpoint 600 seater plane doesn't necessarily offer attractive proposition when you consider how long it will take to board and deplane and it's not so great for the airline to turn that thing, it's so big that it can't even legally operate at some airports without a waiver, having boeing built the 787 anticipating that it would go different way, instead of New York Heathrow continuing to be such a vital transatlantic market that increasingly you'd see what we've already been seeing since the introduction of the 767 which is over flight, so now you've got to the point where alliances you had Memphis Amsterdam is a viable transatlantic market well that's two pretty small markets linked together but it worked for NorthWest KLM because they have a hub on each end, and then you could build an aeroplane from onesies and twosies from connecting points beyond each of those hubs.

So hardware also plays a part, a factor on how this all plays out?

Yes.

With 787 and A350 coming on line, are we saying the hubs become less important in the future, and perhaps hubs exist today because of the bilaterals being specifically between city A and city B in pairs. I don't know the US market that well, but is there perhaps a market for Milwaukee to say Cologne or wherever, but they haven't been possible to date because of the entry exit point regulations in the USA, perhaps that needs change in lieu of the 787 and A350 coming online.

So I think again it is a continuation of a trend we have been seeing, so we have had open skies on the North Atlantic for about twenty or so years now, and we have had the 767 around for even longer than that, and so that opened up a lot of ... you know... New York Heathrow is still a big important market because there is lots of people that go between New York and London and there is no logical connecting point between them. In the old days a lot of people travelled between New York and London because they really wanted to go from Detroit to Düsseldorf and so they flew Detroit in New York, New York London, London Düsseldorf, well now instead of that sort of double connection it's a lot better to go non-stop if it’s available in the case of a Detroit Amsterdam which is not a traditional trans Atlantic market but at one point supported as many as five daily flights between North West and KLM because there were so many people who found it convenient to go, say from Michigan were the largest urban working population is, via Amsterdam to points in the Middle East as an example. So yes over flight is already making hubs less important, most of them are still important because they a large local market, but I mentioned Narita before is not as important as it used to be, China has been growing so fast lots of traffic to China now will simply overfly Japan instead of going via Japan.

I suppose with the Asian market coming up, will the East West flow change from it going, is there perhaps an undeveloped hub in the pacific, to connect Asia and Australia with North and South America?

So the gulf carriers are already doing some of that, well more to Europe than to the US as the distance going around, but the Pacific ughh Australia via East Asia to the us is pretty circuitous, so for the Australian market wants to go non-stop to the US west coast, so the the Pacific doesn't really have a population centre in the middle of it.

No hope for Guam then?

Not really.

Looking forward do you see regulation ever falling away to a truly liberalised industry and more importantly a globalised industry, it could be argued that the airline is probably the last mature industries not to globalise?

So I have to go back to where we started, I really don't hear anybody talking seriously about cross-border ownership and I gave you a couple of examples where if I were an airline in a small tourism dependent country or I was so the political leadership of the US where I would never support that, potentially, never is a long time, but I can’t foresee conditions were that changes at this point. I think there will be incremental progress maybe the alliances will evolve into something more approximating global carriers but I don't see the ownership limitations changing in my lifetime. I turned 50 the other day if that helps you estimate the timeframe.

To me the alliances have the issue where all the members are equal, except some members are more equal than others.

That is exactly true.

Would it not be better if the alliances, could perhaps not necessarily have the ownership, but the management structure changed, like Etihad, Darwin, Air Seychelles, Etihad is placing the management to actually run the airlines, yet their ownership is around 25%, do you think alliances could move to a decision making position for the benefit of the greater whole, with only marginal equity stake?

So you raise a good point because Etihad appears to be building a different model, it doesn't look like the other global alliances it's a set of equity stakes, it seems to come with in some cases more, in other cases less, integration or influence whatever the word is, so they got quite a normal stake in Air Lingus it doesn't seem to be much going on there, right on up to the other side of the scale with Darwin, and Air Seychelles where they have a management contract I guess, and then there are maybe Air Berlin might be somewhere in between that, they've got I've noticed some branding where the two logos together, and got some link cooperation on Abu Dhabi to Berlin and stuff like that, so I guess that's an alternative, I haven't worked out for myself exactly where they're headed with that, I am more familiar with the existing alliance model, but is that possible that it could go that way? Sure I don't see anyone else's felt the need to copy them yet, I think probably because others probably haven't quite figured out where they headed with it yet. But if it looks like what they doing is benefiting them, I don't know why they wouldn't be copied. It does take good it does take deep pockets to build something like that because some of their investments have been loss-making enterprises like Alitalia.

Moving away from Etihad, and looking at CONSORTIUM A, I know that consolidation is European bound, but by I suppose having one finance department, one CEO, one person, do you think Airlines consolidated into one true organisation will be better or worse off in the long run?

Surely you save some costs, with a single finance department only has to be 20% bigger than it was for the BA to manage handling the Iberia part of things as well, but look at Lufthansa they've got Swissair, Austrian and SN Brussels and still they are having to German wings to cope with the low-cost carriers, and absolutely have their hands full with that, I think for the European carriers the cost savings are nice but not enough, it may accelerate the imperative of consolidation in Europe to look more like the US where you have got three really big network carriers now, and one really big domestic point to point carrier, and then a couple of other strong niche brands whose growth potential is limited I suppose a bit, well it's limited to the extent that they can be profitable, competing against the big guys, as long as there are staying out of their way, they've got some room to grow but it's limited, exception of spirit whose costs, seem to be so low that there are able to compete quite effectively, but they are also careful to spread their pain around, they have not caught the full attention of anyone of the three big network carriers.

NIche players include Airtran and Frontier?

So AirTran is part of Southwest now, they still have a separate operating certificate, the brand is still out there but they owned by SouthWest will be extinguished as a brand in the near future. But before that happened, yes they were a niche player although they are were primarily centred on the Atlanta hub so they were the spill carrier from Delta airlines, they kept a cost structure low enough to be able to survive on that.

They also had a low cost premium cabin, which South West is staying clear of?

That’s right and Airtran sold that at a pretty modest premium, but given the cost structure they had it worked for them, they were reasonably successful doing that. I think the acquisition by Southwest made sense for them though because their prospects for growing were somewhat limited and Southwest needed them as their ability to grow organically was kind of limited, they just bought their way into another hundred aircraft from Airtan and a position in Atlanta where they had never cracked yet.

So the synergy was perhaps a combination of Atlanta, and a similar fleet to what they use, Airtran uses a 737 and a 717 I think?

South West had no 717 so that would’ve been a new type, but they actually sold that Type to Delta.

The other niche player would probably be Jet Blue?

Yea you got Virgin America, Jet Blue, Frontier and Alaska that all occupy niches, Frontiers is a Denver based hub, there is a lot of competition from Southwest, United so Frontier is pretty threatened. Alaska enjoys a very protected position in Seattle flying to and from Alaska which is theirs and theirs alone, and they enjoy sitting the place that is not in the middle of the country so it's not exposed to a lot of competition for connecting itineraries, and they sit there with Boeing and Starbucks and Nordstrom and Costco and Microsoft and lots of other companies so I think they do quite well there, but Delta is building up a Pacific gateway there, so there position is a bit threatened as well. Jet Blue and Virgin America those are well thought of brands, and Jet blue seems to be doing okay, Virgin America not as well financially last I looked but they started life as an attractive brand which is not the traditional position for a low-cost carrier, and Jet Blue is reliant on a lot of cross-country traffic that has forced them to introduce a luxurious premium product, which was not really part of their previous business model but the big guys upped the stakes, and they had to compete in those markets they had to introduce that product.

Are there any levers in the industry specifically strategy or business model based affecting the regulatory environment decisions or operating to the regulatory constraints. Are there any levers that you want me to consider that I have not brought up this evening?

Sorry levers in the regulatory environment we haven't discussed is that the question?

Levers management have at their disposal to either deal with, or would like to change, so that they could approach things differently in terms of the regulatory environment?

So I am just thinking right now about the kind of things I hear CEOs talking about and asking for... not really the regulatory environment between airlines but you probably aware that Delta has been fighting a battle against boeing with the US export import bank which essentially provides a backstop sort of subsidy for the export of Boeing products but some of those are going to to the Gulf carriers, then in turn competing against Delta, so Delta and other US carriers, so Delta has taken a strong position against the renewal of financing for that entity and even though Boeing is the single largest USA positive side of the ledger on trade deficit, so that's something that the US CEOs are concerned with, but that not airline regulatory environment that’s a political issue.

That came up in SA as well, the national carrier pays to a development fund, well they don’t pay but the manufacturer pays a certain percentage on acquisitions and the private carriers have a waiver. The national carrier therefore argues their fleet is more expensive. Despite the manufacturers paying this duty, that cost is either added on, or discounted from the private carriers costs, depending on which side of the fence you sit.

Interesting, I didn't touch on taxes, it's a big deal in the US the CEOs will talk about the industry being used as an ATM. In theory the taxes from airline journeys are meant to be funding, security or other improvements at airports are other things related to the business, it's widely accepted that that's not fully the case, by imposing taxes on the travelling public, that it's a relatively invisible source of revenue for the government relatively painless, rather than people writing a cheque at the end of the year, out of their income taxes or paying out of their salaries at the end of the year. That's a big one in the US, there are other regulatory things like Europe has a very generous denied boarding compensation regime for passengers that the carriers don't like it, and they complained about it when it was introduced, but you deal with it and it simply becomes part of doing business, but if they could get their way not to have that.

Is the European denied boarding a type of penalty, or are they taxes?

So no, it just mandates that in the event of an irregular operation what the carrier has to compensate the passenger, traditionally and I’m not super familiar with it in detail in Europe, but in the US for example if it is an act of God it is not the airlines fault they don't owe you anything, if it's their fault they owe you some compensation, including potentially overnight accommodation, and if it's your fault they certainly don’t owe you anything and may charge you a change fee for missing your flight, in practice they don't always do that but that's theoretically how it can work. The not so new rules now, they have been in place for a little while in the EU mandate like a €500 compensation level that is above what's traditionally been required and it's just the details of what I can recall, it’s just stricter and more onerous than what was in place before that in Europe or elsewhere.

INTERVIEW ENDS

9.5. Popular Press

9.5.1. News24 report 2 November 2014

http://www.fin24.com/Companies/TravelAndLeisure/Southern-Africa-must-align-air-travel-policies-20141102

Southern Africa must align air travel policies

Carin Smith

Flic en Flac - Well-intentioned but sometimes conflicting policies on transport, trade, immigration, tourism, taxation and environmental affairs diminish southern Africa's competitiveness and attraction as a destination for business, Chris Zweigenthal, CEO of the Airlines Association of Southern Africa (Aasa), said on Friday.

“The confusion and mixed signals transmitted by governments also compound the many other challenges which the industry faces, including high costs of jet fuel, infrastructure, safety, security and the environmental costs, constraints on ownership, control and market access, all of which impact the region’s airlines’ sustainability and growth,” he said.

“As a result, they blunt the region’s ability to stimulate trade, tourism and economic growth nationally and regionally.”

Zweigenthal was one of the opening speakers at the 44th annual general meeting of Aasa taking place in Mauritius. Aasa represents most of the airlines in the southern African and Indian Ocean region.

Regional forum could promote growth

Zweigenthal proposed the establishment of a regional forum where governments and the air transport industry can engage constructively on policies and eliminate impediments to trade, tourism and economic growth. Such a forum could also close gaps that exist between government policy and commercial air transport industry strategies.

Airlines in the United Arab Emirates and those from Kenya and Ethiopia are succeeding, in his view, because they aligned economic growth strategies.

"If we are serious about growing our economies, then governments and the airline industry must constructively engage to ensure that existing and future policies are conceived and implemented so that they do not have unintended negative consequences," Zweigenthal said.

An example for him is what he calls "the encouraging engagement" between South Africa's department of home affairs and the industry on the implementation of the new immigration regulations.

There are 24 major airlines in the southern African and Indian Ocean region; nine of these are profitable, nine are not and the status of the rest is undisclosed. Twelve of the region's airlines are engaged in turnaround strategies, restructuring or busy launching their operations.

9.5.2. Tourism Update report 31 October 2014

http://www.tourismupdate.co.za/NewsDetails.aspx?newsId=74653

SOUTHERN AFRICAN
TOURISM UPDATE
ONLINE DAILY NEWS

Transport department reneges on UAE airline deal
31 Fri, Oct 2014

Shortly after Emirates launched its fourth daily Johannesburg-Dubai flight, the South African Department of Transport has moved to block the additional flight, calling for a review of the bilateral agreement between SA and the UAE.

The DoT was quoted in *Business Day*, saying that the decision was not for the benefit of SAA but all airlines. It said although the department was not unduly concerned by Emirates' encroachment on the market, it remained its duty to ensure the protection of the aviation industry. "The protectionist approach is being practised everywhere in the world and it should not be viewed as protecting one airline, but is for the benefit of the general populace of SA," Spokesman **Tiyani Rhikhotso** said.

Department Deputy Director-General of Aviation, **Zakhele Thwala**, told *Tourism Update* he had had a meeting with Emirates in December last year at the ICAN conference in Durban. During this meeting, Thwala said he had expressed his wish to review the bilateral agreement, which was signed in 2007, that allowed Emirates to operate a fourth daily flight.

When Emirates announced its intention earlier this year to still go ahead with the fourth frequency, Thwala informed the airline he would oppose the frequency. However, Emirates approached the court and won an urgent interdict permitting it to proceed.

But the interdict is not final, Thwala said. He added that the DoT could still approach the court to review the matter and set aside the current decision. "In the bilateral agreement there are provisions for a dispute resolution mechanism if the two countries do not agree," he said, adding that the matter was now in the hands of the ministers of South Africa and the UAE.

According to the same *Business Day* article, the dispute has led to diplomatic fall-out between the UAE and SA, with the UAE having written to Transport Minister, **Dipuo Peters**, asking for an explanation. "Discussions are taking place between SA and the UAE. We are confident that we will soon find each other on the matter in the dispute," Rhikhotso said.

Airlines around the world have also expressed their concern that the Middle Eastern carriers have started creating an un-level playing field. When SAA reported an operating loss of R991m for the financial year 2012/2013 in January, the airline cited the weakened rand and said increasing levels of competition and Middle Eastern carriers characterized the period.

Lufthansa recently mentioned in its policy brief that in international aviation, airlines put their faith in the principle of mutual benefit laid down in the bilateral agreements but that this balance hasn't existed for a long time when it comes the Middle Eastern carriers.

The brief outlines: "Today, Emirates, Etihad and Qatar have created gigantic growth, which is not based on natural demand but rather is aimed at weakening EU hubs and diverting travellers through their own hubs."

Dorine Reinstein

9.7. Freedoms of the sky

1st freedom:

The right to fly over another nation's territory without landing (overflight)

2nd freedom:

The right to land in a foreign country for non traffic reasons, such as maintenance or refueling, without picking up or setting down revenue traffic

3rd freedom:

The right to carry traffic (people or cargo) from own State A to treaty partner State B

4th freedom:

The right to carry traffic (people or cargo) from treaty partner State B to own State A

5th freedom:

The right to carry traffic between two foreign countries with services starting or ending in own State A (i.e. "beyond rights")

6th freedom:

The right to carry traffic between two foreign countries via State A. Combines two sets of 3rd and 4th freedom rights as so it is rarely specified explicitly in Air Service Agreements

7th freedom:

The right to operate stand-alone services between two foreign states which lie entirely outside A

8th freedom:

The right to carry traffic between two points within a foreign state on a service originating or terminating in State A (i.e. consecutive or fill-up cabotage). Example: Alitalia picks up passengers in Atlanta and drops them off in Boston en route to Milan (currently not allowed).

9th freedom:

The right to carry traffic between two points within a foreign state with no requirement to originate or terminate in State A (i.e. pure or full cabotage). Example: German-based Air Berlin flies nonstop between London and Manchester without any connection to Germany.

9.8. Global alliance schedule

9.8.1. Oneworld Alliance

The Oneworld alliance was founded on 1 February 1999 is headquartered in New York City, USA, and is the smallest of the world's airline alliance programs with 14,000 daily departures combined. These flights reach 152 countries, with an annual passenger number of 506 million (Oneworld, 2014).

Members as of May 2014.

Air Berlin	American Airlines	British Airways
Cathay Pacific	Finnair	Iberia
Japan Airlines	LAN Airlines	Malaysia Airlines
Qantas	Qatar Airways	Royal Jordanian
S7 Airlines	Sri Lankan Airlines	TAM Airlines
US Airways		

9.8.2. Skyteam

Skyteam alliance based in Haarlemmermeer, Netherlands was founded 22 June 2000 is the world's second largest airline alliance program with more than 15,700 daily departures combined. These flights reach 178 countries, with an annual passenger number of 588 million (Skyteam, 2014).

Members as of May 2014.

Aeroflot	Aerolíneas Argentinas	Aeroméxico
Air France	Air Europa	Alitalia
China Airlines	China Eastern Airlines	China Southern Airlines
Czech Airlines	Delta Air Lines	Garuda Indonesia
Kenya Airways	KLM	Korean Air
Middle East Airlines	Saudia	TAROM
Vietnam Airlines	Xiamen Airlines	

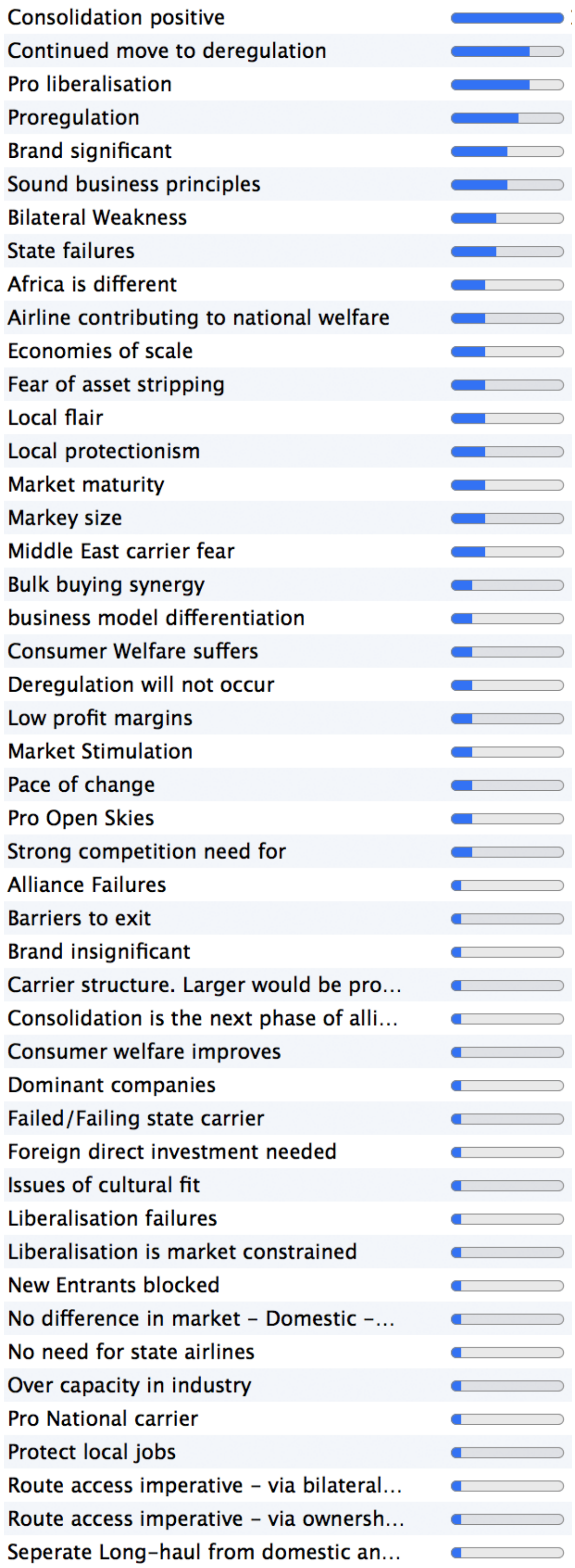
9.8.3. Star Alliance

The Star alliance founded 14 May 1997 is the world's largest airline alliance program with more than 18,000 daily departures combined and is headquartered in Frankfurt am Main, Germany. These flights reach 1,269 airports in more than 190 countries, with an annual passenger number of 637.6 million (Star Alliance, 2014).

Members as of May 2014.

Adria Airways	Aegean Airlines	Air Canada
Air China	Air New Zealand	All Nippon Airways
Asiana Airlines	Austrian	Brussels Airlines
Copa Airlines	Croatia Airlines	EgyptAir
Ethiopian Airlines	EVA Air	LOT Polish Airlines
Lufthansa	Scandinavian Airlines	Shenzhen Airlines
Singapore Airlines	Blue Diamond air	Swiss International
TAP Portugal	Thai Airways	Turkish Airlines
United Airlines	Air India	Avianca Brazil

9.9. Code book


Consolidation positive
Continued move to deregulation
Pro liberalisation
Proregulation
Brand significant
Sound business principles
Bilateral Weakness
State failures
Africa is different
Airline contributing to national welfare
Economies of scale
Fear of asset stripping
Local flair
Local protectionism
Market maturity
Markey size
Middle East carrier fear
Bulk buying synergy
business model differentiation
Consumer Welfare suffers
Deregulation will not occur
Low profit margins
Market Stimulation
Pace of change
Pro Open Skies
Strong competition need for
Alliance Failures
Barriers to exit
Brand insignificant
Carrier structure. Larger would be pro...
Consolidation is the next phase of alli...
Consumer welfare improves
Dominant companies
Failed/Failing state carrier
Foreign direct investment needed
Issues of cultural fit
Liberalisation failures
Liberalisation is market constrained
New Entrants blocked
No difference in market – Domestic –...
No need for state airlines
Over capacity in industry
Pro National carrier
Protect local jobs
Route access imperative – via bilateral...
Route access imperative – via ownersh...
Seperate Long-haul from domestic an...