3

The operating environment for regional air services

Introduction

3.1   The business environment in which regional airlines operate is influenced by some factors external to the individual firms and others that are internal to the firm. External factors range from global issues and events to Australian government policies and the behaviour of other firms in the industry. Internal factors are, for example, the business and technical skills of small operators.

3.2   The network nature of aviation means that economic shocks affecting international aviation have an impact on regional aviation. Equally, government interventions in the domestic aviation industry also impact on the regional aviation sector.[1]

3.3   Government policy issues and their effects on airlines are considered in chapters 6 and 7.

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1   Bureau of Transport and Regional Economics (2003), Working Paper 54, '*Regional Public Transport in Australia: Economic Regulation and Assistance Measures*', p. 21; Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. 42.

Changes in the demand for regional aviation services

3.4   The committee found consensus in the evidence that the regional aviation industry is adjusting to the short and long term shocks that are continuing to affect the demand for regional air travel. The most notable of these shocks are:

   ■ Terrorism and security;

   ■ Ansett's collapse;

   ■ Rising insurance costs; and

   ■ Severe Acute Respiratory Syndrome.

3.5   Ongoing factors that continue to affect the demand for regional air travel are:

   ■ Long-term changes in Australia's population distribution;

   ■ Competition from alternative means of transport and communication; and

   ■ Drought.[2]

3.6   Airline passengers want affordable airfares, comfortable aircraft, convenient flight times and connections to other services and security. The travelling public base their decisions on whether to use road, rail or air transport depending on their circumstances. The cost of airfares appears to be a key issue determining this choice.[3] However, the New South Wales Government and others alluded to road safety as an issue that may not be considered in a person's decision to choose road over air travel.[4]

3.7   The public's expectation of what they should pay for an airfare has been shaped by the discount airfares offered by major domestic airlines between capital cities.[5] This is the result of the Commonwealth's 'open skies' policy that has created strong competition between the major domestic airlines Qantas and Virgin Blue on the trunk routes between capital cities.

2   Department of Transport and Regional Services, submission no. 81, pp. 3-4; Macair Airlines Pty Ltd, submission no. 76, pp. 4-5; Regional Aviation Association of Australia, submission no. 93, p. 3; Regional Express, submission no. 116, pp. 3, 8-10.

3   Orange City Council, transcript of evidence, Sydney, 12 June 2003, p. 494; Macair Airlines, transcript of evidence, Brisbane, 11 June 2003, p. 592.

4   New South Wales Government, submission no. 151, p. 8.

5   Qantas Airways Limited, submission no. 146, pp. 4-5; Tasmanian Government, submission no. 155, pp. 5-6.

3.8   The committee found that people would choose to drive their car for three to five hours instead of flying. The reason given was that cars and major roads are good or improving and road transport is more convenient and represented better value.[6]

3.9   Recent BTRE research showed over the past 15 years that air travel accounted for about 26 per cent of all non-urban passenger travel on a passenger-kilometre travelled basis, and the private car accounted for 65 per cent. Alternatively, for all long-distance regional passenger travel, air accounted for three per cent on a passenger-trip basis, and the private car accounted for 91 per cent.[7]

3.10   Air travel is primarily used for travelling distances over 400 kilometres. Research by BTRE showed that in 2000, about 94 per cent of all car trips are to a destination within 400 kilometres, while the reverse is true for air – over 90 per cent of air trips are to a destination more than 400 kilometres from home.[8]

3.11   Evidence presented to the committee showed that regional air travel was down by 20 to 30 per cent in recent years.[9] BTRE research supported this, showing that total domestic air travel was down by 10 per cent. The demand for air travel was beginning to slow before the recent terrorism and Ansett collapse events. This was explained by airfares having stabilised[10] following aviation deregulation and the heavy discounting that accompanied the struggle for market share. BTRE considered that the prospects for growth in regional air travel were very low.[11]

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6   Qantas Airways Pty Ltd, transcript of evidence, Sydney, 12 June 2003, p. 475; Orange City Council, transcript of evidence, Sydney, p. 497; Sydney Airports Corporation, transcript of evidence, Sydney, p. 513; New South Wales Government, transcript of evidence, Sydney, pp. 526, 529, 551-552.

7   Bureau of Transport and Regional Economics (2003), Working Paper 54, '*Regional Public Transport in Australia: Economic Regulation and Assistance Measures*', p. 8.

8   Bureau of Transport and Regional Economics (2000), Working Paper 51, '*Regional Public Transport in Australia: Long Distance Services, Trends and Projections*', p. 97.

9   Air Link Pty Ltd, transcript of evidence, Sydney, 8 May 2003, p. 545; Regional Express, transcript of evidence, Sydney, 8 May 2003, pp. 556-557; Albury City Council, transcript of evidence, Wagga Wagga, 7 May 2003, p. 433; Hervey Bay City Council; submission no. 186, p. 2.

10   Bureau of Transport and Regional Economics (2003), Working Paper 54, '*Regional Public Transport in Australia: Economic Regulation and Assistance Measures*', p. 8.

11   Qantas Airways Limited, transcript of evidence, Sydney, 8 May 2003, pp. 473-474; Bureau of Transport and Regional Economics (2000), Working Paper 51, '*Regional Public Transport in Australia: Long Distance Services, Trends and Projections*', p. xxvii.

3.12   Qantas drew on the finding of the BTRE research that regional air travel has declined and there is little prospect for growth, saying:

> The underlying economics of operating regional services are not good, and there is only very limited growth potential in regional markets. [BTRE] estimates that over the past 15 years passenger numbers to and from regional airports have grown by about 1.4 per cent per annum and have generally been negative at airports where the throughput is under 10 000 passengers a year. That is clearly reflected in the number of airline operators that have failed and the number of smaller population centres no longer served by scheduled airline services.[12]

3.13   The changing demand for airline services is one of many challenges the industry, particularly regional aviation services, has to face.

The supply of regional aviation services

3.14   The committee found that the major impediments to the expansion of existing regional airlines and the emergence of new ones were costs, route factors, interoperability with major carriers, access to finance and the high cost of new aircraft, the predatory behaviour of larger airlines, the business skills of small operators, and the shortage of pilots and aircraft mechanics.[13]

3.15   Research by BTRE found that airlines are able to control the service quality-price tradeoff, but their ability to influence prices relative to other modes of transport is limited by their cost structures.[14]

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12   Qantas Airways Limited, transcript of evidence, Sydney, 8 May 2003, p. 473.

13   Regional Aviation Association of Australia, submission no. 93; Local Government Association of New South Wales, submission no. 109, pp. 1-2.

14   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. xii.

Costs

3.16   A significant amount of evidence presented to the committee indicated that the costs of operating a regional airline have risen significantly in recent years.[15] This rise in costs appeared to be one of the most significant factors affecting the viability of many operators. If operators are not viable, their withdrawal from the market reduces the supply and therefore the adequacy of regional aviation services.

3.17   Some of the cost increases have come from global issues such as currency fluctuations. The Department of Transport and Regional Services (DOTARS) explained the effect and cause of currency movements by saying:

> … fuel prices fluctuate quite heavily and are probably the largest single contributor to variability in the input costs in the industry. The US dollar's effect on the capital side is also difficult. These things are not entirely in the control of government.[16]

3.18   Currency movements are significant because aircraft are priced in American dollars and fuel prices are based on international prices. Currency movements also affect maintenance costs because most aircraft parts come from the United States. The volatility of currency movements also has substantial impact because it increases the uncertainty of costs, makes financial planning difficult and can affect cash flow.

3.19   During the inspection of its engine maintenance facility at Wagga Wagga, Rex told the committee that major engine overhauls can cost hundreds of thousands of dollars.[17] Even minor currency fluctuations can therefore be significant.

3.20   Island Airlines Tasmania Pty Ltd put fixed and running costs in perspective saying:

> The ongoing costs are what you will pay attention to, not the initial purchase. A new Chieftain would have a $7,000-a-month lease payment. That is insignificant against a $120,000-a-year maintenance bill for labour alone.[18]

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15   Regional Express, submission no. 116, pp. 9-10; Regional Aviation Association of Australia, submission no. 94; National Farmers Federation, submission no. 139.

16   Department of Transport and Regional Services, transcript of evidence, Brisbane, 12 June 2003, p. 652.

17   Regional Express, inspection of Wagga Wagga facilities, 7 May 2003.

18   Island Airlines Tasmania Pty Ltd, transcript of evidence, Tullamarine, 26 February 2003, p. 294.

3.21   There is limited opportunity to pass increased costs on to passengers. Many customers are sensitive to the price of airfares and to changes in airfare prices.[19] Because of people's sensitivity to the prices of alternative means of transport, called cross-elasticity of demand, in many instances they will drive to the destination in preference to flying.

3.22   The committee noted that the BTRE surveys and reports on airline costs and other performance information are in its publication *Avline*.[20] From the evidence presented, the committee considered that the variability of costs has a significant impact on the adequacy of regional air services.

Route factors

3.23   As described above, much has happened in recent years to erode the markets of regional airlines. Evidence suggests that there is little prospect for market expansion in the industry. Another factor impacting on the supply of air services is improved aircraft technology. While technology has made new aircraft more capable, evidence suggests that many markets cannot sustain them.

Sustainability of regional routes

3.24   The viability of a route depends on costs and revenue. Regional airlines are faced with very high capital costs and high operating costs.[21] This makes the cost per seat kilometre very high and reduces profit margins. To remain viable, regional airlines need to operate their aircraft with nearly full loads and have them fully utilised earning income. Load factors of 60 to 70 per cent are sufficient, but in some instances load factors as low as 50 per cent are adequate.[22]

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19   Paul Bredereck, submission no. 42, p. 1.
20   Bureau of Transport and Regional Economics, '*Avline*', Issue One, January 2003, http://www.btre.gov.au, last accessed 6 August 2003.
21   Qantas Airways Limited, submission no. 146, p. 4.
22   Captain Shrubb, submission no. 43, p. 2; Edge Aviation, submission no. 65, 9; Paul Bredereck, submission no. 42, p. 1; Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 642.

3.25   Many routes can only offer small numbers of passengers that will not generate adequate load factors. Other routes such as Flinders Island have strong seasonal flows of passengers in one direction and near empty aircraft on the return leg.[23]

3.26   The viability of regional air routes varies from sustainable to marginal to unsustainable, depending on the customer demand and type of aircraft the operator uses on the route. The smaller the aircraft and the shorter the sector length flown, the higher the unit cost per passenger or seat. Marginal routes that will sustain a Piper Chieftain would not sustain a Dash 8.[24]

3.27   The New South Wales Government offered to the committee the research of Hazelton's administrator and bidders for the airline. This research provided greater clarity on the issue of airline viability (at the time of Ansett's collapse in late 2001).[25] The research found that:

■   Routes with a volume of more than about 100 000 passengers per annum could support two airlines, each using a 36-seat aircraft full time providing three daily services per day to Sydney. Four routes in this category were Coffs Harbour, Albury, Dubbo and Wagga Wagga;

■   Routes with a volume between about 65 000 and 100 000 passengers per annum could support one airline full time and another with a partly committed aircraft, each using a 36-seat aircraft providing three daily services per day to Sydney. Routes in this category were Ballina, Tamworth, Port Macquarie, Armidale, and Newcastle-Williamtown;

■   A route volume of between 35 000 and 65 000 passengers per annum could support only one operator using a 36-seat aircraft full time. Routes in this category were Orange, Lismore and Griffith;

■   A route volume of between 6 000 and 35 000 passengers per annum could support one operator using a 19-seat aircraft on a full time or part time basis. Routes in this category were Taree, Grafton, Moree and Narrandera amongst others; and

■   Routes with volumes of less than 6 000 passengers per annum could only support nine to 12-seat aircraft. Routes in this category were Inverell, Glenn Innes and Bourke amongst others.

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23   Tasmanian Government, submission no. 155, p. 5; Tasmanian Government, transcript of evidence, Launceston, 24 February 2003, pp. 62, 76.

24   Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 644; Paul Bredereck, submission no. 42, pp. 1-2; Qantas, submission no. 146, p. 4.

25   New South Wales Government, submission no. 151, pp. 7-8.

3.28   In the current New South Wales regional aviation market, the New South Wales Government considered that routes with volumes of 65 000 to 35 000 passengers per annum would support up to a 19-seat aircraft.

3.29   The Western Australian Government commissioned research from Tourism Futures and the Centre for Asia Pacific Aviation that was completed late in 2002.[26] The Western Australian Government has used this research to assist it in adjusting its aviation policy.

3.30   The research classified routes into five classes ranging from those that could sustain competition with jet aircraft to those routes that may require government subsidisation. Western Australia's routes can be characterised as having long sector lengths compared with other states.

3.31   In general terms, routes with a volume of more than 100 000 passengers per annum (carried in both directions) could support competition amongst jet operators. Routes in this category are Perth to Broome, Karratha and Kalgoorlie.

3.32   The research also found that in general terms for turboprop aircraft:

■   Routes with more than 60 000 passengers per annum (carried in both directions) could support competition amongst turboprop operators, although competition would have a potentially destabilising impact on the RPT network. The Perth to Geraldton route was the only route in this category;

■   Routes with between 40 000 and 60 000 passengers per annum, are unlikely to sustain competition. These routes would need to operate as a network (hub services) to maintain a viable and ongoing level of service to regional communities. Competition would undermine the capacity of existing operators to cross-subsidise marginal services. Some routes in this category are Monkey Mia, Kalbarri, Laverton and Leonora;

■   Routes between 10 000 and 40 000 passengers per annum could operate commercially but not competitively. Competition could result in a degraded service and medium-term instability. These routes are likely to require an exclusive licence to be viable on an ongoing basis. Examples of these routes are Perth to Albany, Esperance, Carnarvon, and Broome to Kununurra; and

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26   Tourism Futures, and Centre for Asia Pacific Aviation (2002), '*Review and assessment of the Effectiveness of Air Services in Western Australia, Overview Report for Department for Planning and Infrastructure*', pp. 24-25, http://www.dpi.wa.gov.au, last accessed 11 September 2003.

- Routes with less than 10 000 passengers per annum generally need to be part of a network to operate commercially or may require a subsidy. Routes include the network Exmouth to Broome via Karratha and Port Hedland, and the routes Broome to Wiluna, Derby, Fitzroy Crossing and Halls Creek, and Perth to Meekatharra and Wiluna.

3.33   Island Airlines Tasmania Pty Ltd told the committee that the cost of operating a turboprop aircraft is about double that of a piston-engined aircraft. Economies of scale in the turboprop aircraft are not realised until the seating capacity of 18 is reached. At this point the cost per seat kilometre of each aircraft is reached:

> In aircraft of nine seats, if we look at an analysis, say, of running a turbocharged piston engine aircraft as against a turboprop, we find the seat to mile cost of a turboprop aircraft is nearly double that of a piston engine aircraft of roughly the same seat capacity. Although turboprops are much more reliable, they do not tend to have the same economic capacity until you get to about the 18-seat capacity, and then you start getting economies of scale, which means you are starting to get to roughly the same operating costs per seat as a piston engine aircraft.[27]

3.34   Qantas provided to the committee a comparison of a 36-seat aircraft operating on a regional route and a 260-seat aircraft operating on a trunk route:

- The crew costs per seat on a 36-seat aircraft are four times per seat greater than for a 260-seat aircraft;

- The maintenance costs per seat on the same 36-seat aircraft are more than twice those of the 260-seat aircraft;

- Aircraft ownership costs for the 36-seat aircraft are more than 50 per cent higher per seat than the 260-seat aircraft; and

- Landing and enroute charges for the 36-seat aircraft are more than 40 per cent higher per seat than the 260-seat aircraft.

3.35   Research from BTRE supports these findings. These findings are summarised in Figure 2.1 and show that:
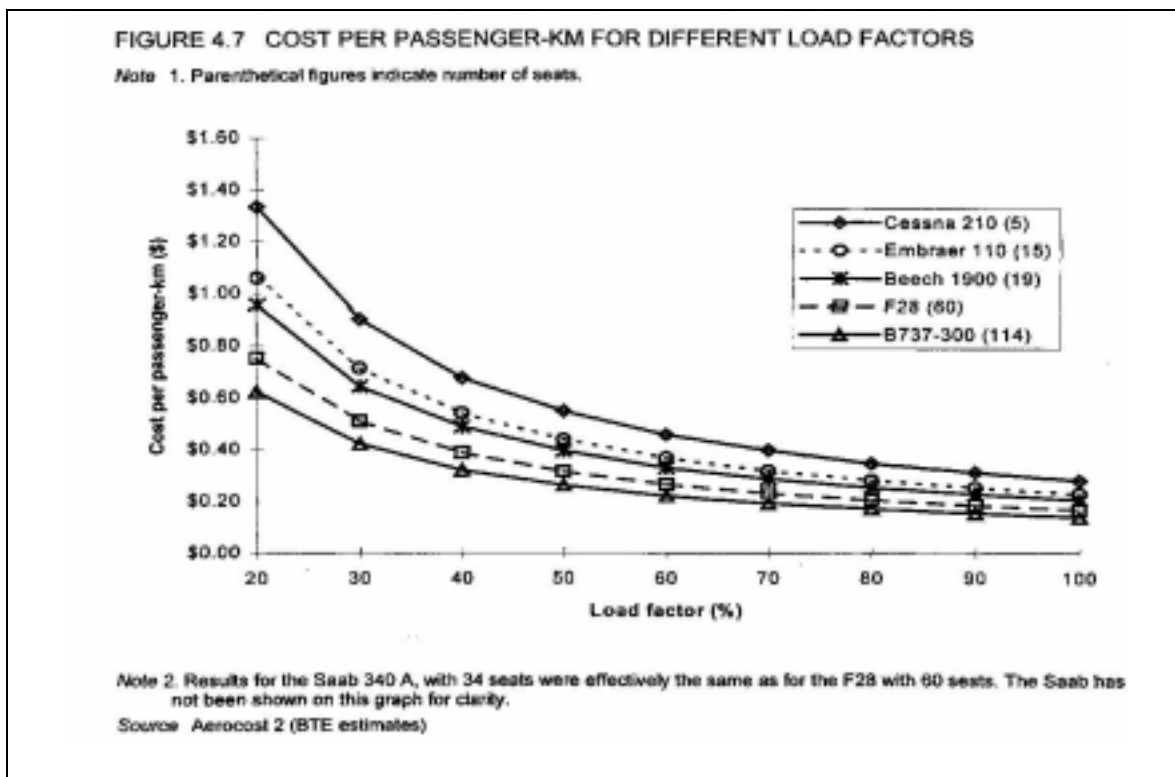
- The cost per seat generally declines as the aircraft size increases, because the fixed costs are spread among more passengers;

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27   Island Airlines Tasmania Pty Ltd, transcript of evidence, Tullamarine, 26 February 2003, p. 282.

- The cost per kilometre flown declines as the stage length increases. Propeller aircraft are cheaper to operate over shorter distances than jets;

- All aircraft are relatively expensive to operate over distances up to 200 kilometres; and

- The cost per passenger declines as the percentage of seats filled on the aircraft increases.[28]

Figure 3.1 Cost per passenger-kilometres for different load factors.[29]

FIGURE 4.7   COST PER PASSENGER-KM FOR DIFFERENT LOAD FACTORS

Note 1. Parenthetical figures indicate number of seats.

Note 2. Results for the Saab 340 A, with 34 seats were effectively the same as for the F28 with 60 seats. The Saab has not been shown on this graph for clarity.

Source Aerocost 2 (BTE estimates)

3.36   From an operator's perspective, an ideal route should have passengers and freight. The passengers should comprise a mix of different types of passengers paying a fare according to their preference. Business passengers can afford to pay the highest fare and want the flexibility of being able to obtain a seat at the last minute. Many people travelling by air

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28   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. 59-60.

29   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. 61.

for leisure or visiting friends and relatives are less willing and often less able to pay the full fare.[30]

3.37 Given these passenger preferences, airlines are able to obtain a higher price for business related air travel. International evidence suggested that business and government travellers can represent up to 50 per cent of passengers and provide up to 80 per cent of revenue. In Australia, recent research indicated that around 65 per cent of regional air passengers were business travellers.[31] The larger routes regional routes to and from say Coolangatta or Launceston are more likely to offer these characteristics than smaller routes to remote communities in Western Australia or Northern Territory.

3.38 To improve their revenue, operators can use yield management techniques. Yield management enables the airline to compare the demand for seats or freight space with potential supply on a route and set fares and space availability accordingly.

3.39 Revenue depends on the number of paying seats occupied, the yield from each seat (load factor x yield) and the reliability of the aircraft to deliver the service.[32]

3.40 Using yield management, an airline knows how many of each type of fare to offer to increase the revenue. Yield management relies on airlines using the electronic commerce-based booking systems linked with the global distribution systems such as Apollo, Sabre, Amadeus, Galileo or Abacus.[33]

30 Tasmanian Government, submission no. 155, p. 5; Queensland Government, submission no. 153, p. 5; Department of Industry, Tourism and Resources, submission no. 159, p. 6; Grossman, D, '*Restructure the airline industry? Dream on*', http://usatoday.printthis.clickability.com, last accessed 1 August 2003; Costa, P.R., Harmed, D.S., and Lundquist, J.T., '*Operations Strategies in the Airline Industry*', McKinsey Quarterly, 31 December 2002, http://bctim.wustl.edu/topics, last accessed 4 August 2003; Leeton and Narrandera Shire Councils, transcript of evidence, Wagga Wagga, 7 May 2003, pp. 444-445; Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. xii, 43-53.

31 Grossman, D, '*Restructure the airline industry? Dream on*', http://usatoday.printthis.clickability.com, last accessed 1 August 2003; Costa, P.R., Harmed, D.S., and Lundquist, J.T., '*Operations Strategies in the Airline Industry*', McKinsey Quarterly, 31 December 2002, http://bctim.wustl.edu/topics, last accessed 4 August 2003; Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. xii, 43-53.

32 Paul Bredereck, submission no. 42, p. 1-2; Macair Airlines, submission no. 76, p. 6.

33 Optims, 'Definition and history of yield management', http://www.tims.fr/UK/hight_profits.html, last accessed 14 July 2003; 'Yield Management a Growth Key Driver', http://airlinesgate.gree.fr/articles/growth_drivers.htm; last accessed 4 August 2003;

3.41   An alliance with a larger airline can provide the regional airline access to electronic commerce-based booking systems linked with global distribution systems. The issues surrounding electronic commerce based booking systems are discussed later in this chapter.

Regional hub services

3.42   Given the variability of costs and marginal viability of many regional routes, models for assessing and delivering are critical. There are two contending models for providing air services: the point-to-point model and the hub-and-spoke model.

3.43   The point-to-point model for air services has one airline flying from one airport to another.

3.44   The hub-and-spoke model has smaller airlines operating on the 'spokes' flying between a large regional centre and smaller outlying towns. A larger carrier provides a linking service from the large regional centre to another major port such as a capital city.

3.45   Regional hub services have been suggested as a solution to building a critical mass of passenger numbers at certain larger regional airports for their movement to capital cities. Regional hub services could improve the viability and adequacy of regional air services[34] and reduce air traffic congestion at capital city airports.

3.46   A significant amount of evidence presented to the committee indicated that hub services are uneconomic at smaller regional centres. Regional operators claimed that hub services are very costly to the airlines on the 'spokes'.[35] This is because the spoke airline would generally fly short sector lengths which are subject to higher costs. Most costs of operating an aircraft are incurred in taking off and landing rather than during cruising at altitude. Where there are more takeoffs and landings, maintenance costs

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Davis, P., '*Airline Ties Profitability Yield to Management*', SIAM News, Vol. 27 No. 5, May/June 1994.

34   Department of Transport and Regional Services, submission no. 81, p. 5.

35   Macair Airlines Pty Ltd, submission no. 76, p. 6; Paul Bredereck, submission no. 42, p. 3; Narrandera and Leeton Shire Councils, transcript of evidence, Wagga Wagga, 7 May 2003, p. 439.

are also higher because of increased wear and tear on engines.[36] Short sector length flights are therefore more expensive to operate.

3.47 Paul Bredereck explained to the committee the cost penalties of operating hub-and-spoke services:

> I am personally not a proponent of hub services. The reason is that the bulk of the cost on regional air services is in your take-off and your landing. Once you are up in the cruise it is just burning a little bit of fuel. To operate into a hub you duplicate and multiply your costs.[37]

3.48 A further difficulty of the hub-and-spoke model is the time penalty it may impose on passengers.[38] The importance of time to travellers was explained by a number of witnesses who told the committee that, unless an air service can save a passenger a three to five hour drive, people will drive to the nearest major centre.[39] Hub services must be timed to coincide with other linking services at capital cities and have access to landing slots at major airports. However, if passengers have to wait to make connections from hub services to major carriers, they may choose to drive instead.

3.49 Brindabella Airlines told the committee that its clients preferred point-to-point services over hub-and-spoke services:

> …the success of our Williamtown service seems to be based around the fact that people have rejected the hub-and-spoke-through-Sydney idea.[40]

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36 Regional Express, transcript of evidence, Sydney, 8 May 2003, p. 460; Lance Watson, transcript of evidence, Sydney, 8 May 2003, p. 484.

37 Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 647.

38 New South Wales Government, submission no. 151, p. 6.

39 Air Link Pty Ltd, submission no. 94. p. 3; City of Albury, transcript of evidence, Wagga Wagga, 7 May 2003, pp. 425-426; Leeton and Narrandera Shire Councils, submission no. 74, p. 1; Leeton and Narrandera Shire Councils, transcript of evidence, Wagga Wagga, 7 May 2003, pp. 439, 445; Brindabella Airlines, transcript of evidence, Wagga Wagga, 7 May 2003, p. 451; Paul Rees, transcript of evidence, Wagga Wagga, 7 May 2003, p. 466; Orange City Council, submission no. 138, pp. 1-2; Orange City Council, transcript of evidence, Sydney, 8 May 2003, pp. 494, 501.

40 Brindabella Airlines, transcript of evidence, Wagga Wagga, 7 May 2003, p. 451.

3.50   For regional airlines to be viable, operators must provide the convenience that passengers want. This requires a streamlined interconnectivity between spoke and hub service operators, which has been achieved in some instances by an interline agreement. The issue of interoperability and airline agreements is considered in more detail later in this chapter.[41]

3.51   Currently, many regional air services have ceased and larger airlines are using hubs centred on the larger centres such as Cairns and Melbourne, Canberra, Brisbane, Sydney and Adelaide.[42] Such hubs are inconvenient for passengers wanting to travel between regional centres. These hubs may discourage tourism[43] and increase airline costs.

3.52   Despite these criticisms, there was some evidence that hubs have applications in certain circumstances.[44]

3.53   Air Link Pty Ltd, based at Dubbo, New South Wales, operates a very successful hub operation. The service collects passengers from outlying towns early in the morning, collects additional passengers at a major regional centre such as Dubbo, and carries the passengers on to Sydney.[45]

3.54   Rex does not use hubs for its operations. However, two other airlines, Aeropelican and Horizon, have requested Rex to be part of hub operations.[46]

3.55   Macair uses a mini-hub at Mt Isa, but uses the point-to-point model elsewhere in Queensland to connect to major coastal centres of Brisbane, Townsville and Cairns. This combination of hub and point-to-point services enables passengers to make other connections.[47]

3.56   A triangular hub is operating to Griffith and Narrandera in New South Wales.[48]

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41   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. 47-48.

42   Queensland Government, submission no. 153, pp. 9-11; Government of Tasmania, transcript of evidence, Launceston, 24 February 2003, p. 75; Latrobe City Council, transcript of evidence, Tullamarine, 26 February 2003, p. 175.

43   Hervey Bay City Council, submission no. 186, p. 2.

44   District Council of Grant, transcript of evidence, Adelaide, 14 April 2003, pp. 319-323.

45   Air Link Pty Ltd, submission no. 94, pp. 1-2; New South Wales Government, transcript of evidence, Sydney, 8 May 2003, p. 524.

46   Regional Express, transcript of evidence, Sydney, 8 May 2003, pp. 565-566.

47   Macair Airlines Pty Ltd, transcript of evidence, Brisbane, 12 June 2003, p. 594.

48   New South Wales Government, transcript of evidence, Sydney, 8 May 2003, p. 524; Narrandera and Leeton Shire Councils, transcript of evidence, Wagga Wagga, 7 May 2003, p 435.

3.57   The Regional Aviation Association of Australia told the committee that the United States used the hub-and-spoke model 10 to 12 years ago. However, as airlines are now returning to the point-to-point model.[49]

3.58   Qantas said that hubs have merit in limited circumstances, but are not a solution to the decline of services in regional centres.[50]

3.59   The 'hub-and-spoke' model has been rejected by foreign national and international carriers in the current business environment. The point-to-point model is used by smaller airlines because it keeps costs relatively low.[51]

3.60   While some evidence suggested that government subsidies should be used to encourage hubs[52] the Regional Aviation Association of Australia told the committee that most operators did not support subsidies. Operators, they claimed, just wanted a fair go at making money.[53]

3.61   This was confirmed by other evidence that suggested that government did not have a role in encouraging the formation of hub-and-spokes.[54] The committee formed the opinion that the hub-and-spoke business model for regional air services had limited applications in the current business environment of high operating costs and low and declining passenger numbers. While it can be argued that the hub-and-spoke model provides the critical mass of passenger numbers that make services economic to provide, the cost and time penalties make them unattractive for airlines and passengers.

3.62   However, the committee considered that the decision on which was the most appropriate model to use was a commercial one. Consequently, there is no role for government to encourage the development of hub-and-spoke services.

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49   Regional Aviation Association of Australia, transcript of evidence, Canberra, 18 June 2003, p. 709.

50   Qantas, submission no. 146, p. 6.

51   Ferguson, A., '*Wounded Kangaroo*', BRW, p. 35; Woods, W., Atlanta Business Chronicle, '*Frustrating times for Delta*', http://www.bizjournals.com/atlanta/stories/2002, last accessed 31 July 2003; Hansson, T., Ringbeck, J., and Franke, M., '*Flight for Survival: A New Operating Model for Airlines*', http://www.strategy-business.com, last accessed 31 July 2003.

52   Bundaberg City Council, transcript of evidence, Brisbane, 12 June 2003, p. 607; Riverina Eastern Regional Organisation of Councils, submission no. 152, p. 1.

53   Regional Aviation Association of Australia, transcript of evidence, Canberra, 18 June 2003, p. 709.

54   Australian Airports Association, submission no. 93, p. 4.

Predatory behaviour of larger airlines

3.63   The committee heard evidence that larger airlines have entered the routes of smaller airlines in an attempt to increase their market share. Once the smaller airline had been forced out of business the larger airline then withdrew from the route or increased its ticket prices.[55] Other than the example discussed in chapter 2 concerning Virgin Blue's attempt to commence a service to Mt Isa, the committee did not receive evidence that named other routes where predatory behaviour had occurred or evidence that named larger airlines which had practiced such behaviour. The committee understands the reluctance of smaller airlines to provide names or specific examples of where this behaviour might have occurred.

3.64   A possible explanation for this predatory behaviour is the struggle for market share, particularly following deregulation. The larger airline could offer lower fares, better aircraft and better services. However, once it is established in the new route it finds the route to be unviable and withdraws. The community is then left without a service. In this environment, a new operator may have difficulty re-establishing a service due to the lack of community support.

3.65   The committee noted that in a competitive business environment predatory behaviour can occur. Although this type of behaviour obviously impacts on the viability of regional airlines, it is not considered one of the major factors affecting the industry. The committee notes that competition laws and trade practices legislation offer some protection against this behaviour. State government route protection also offers some protection to existing operators, as the Western Australia, Queensland and the New South Wales governments told the committee.[56]

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55   New South Wales Government, transcript of evidence, Sydney, 8 May 2003, pp. 522-523; Edge Aviation, submission no. 65, p. 2.

56   Western Australia Government, transcript of evidence, Canberra, 10 September 2003, p. 740; New South Wales, transcript of evidence, Sydney, 8 May 2003, pp. 522-523.

Access and interoperability with major carriers

3.66   Airlines often enter agreements with other carriers to integrate their functions to provide a range of improved networks, services and facilities for travellers, including computerised reservation systems.

Agreements between airlines

3.67   A number of regional airlines and the RAAA said that it is vital for a regional airline to negotiate an agreement with major airlines.[57] This agreement provides the regional airline with access to the major airline's computer reservation system, technical and information technology support, through-ticketing, on-carriage to and from trunk services, ground handling and ramp handling services and terminal facilities.

3.68   Three common types of agreement are alliance, code sharing and interlining:

- An *alliance agreement* - this involves high level cooperation and may include the integration and consolidation of resources, coordination of schedules, services and marketing, as well as revenue sharing;[58]

- A *code sharing agreement* - this is the assignment of one airline's designator code, e.g. QF for Qantas, to a flight operated by another airline.[59] A code share agreement between two carriers commonly specifies the services each carrier will perform, the insurance requirements, a schedule for sharing the revenue and the origin and destination of the flights to be code shared and operated by each carrier;[60] and

- An *interlining agreement* – this gives one carrier the authority as agent to issue tickets for the carriage of passengers and/or freight on behalf of the other carrier. It involves the coordination of baggage checks, carriage or air cargo, and the honouring of tickets between airlines. The

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57   Macair Airlines, submission no. 76, pp. 4-5; Brindabella Airlines Pty Ltd, transcript of evidence, Wagga Wagga, 7 May 2003, p. 450; Regional Express, transcript of evidence, Sydney, 8 May 2003, p. 556; Regional Aviation Association of Australia, submission no. 93, p. 9.

58   '*Code Sharing, Issues and Solutions from the Perspective of Leading Underwriters and Aviation Counsel*', March/April 2000, p. 4., www.baig.co.uk, last accessed 1 August 2003.

59   Productivity Commission, '*International Air Services*', Report No. 2, 11 September 1998, p. XIV, www.pc.gov.au, last accessed 1 August 2003.

60   '*Code Sharing, Issues and Solutions from the Perspective of Leading Underwriters and Aviation Counsel*', March/April 2000, p. 4., www.baig.co.uk/white%20paper.pdf, last accessed 1 August 2003.

identity of each carrier is maintained whereby the operating carrier's designator code to identify the flight.[61]

3.69   The evidence indicated that an agreement between a regional airline and the major airlines to work together provides benefits to both parties. The smaller regional airline partner benefits from offering its passengers to or from a domestic or international destination a better quality of service. This may entail relatively seamless travel across an expanded route network, better connections, increased frequent flyer program benefits, and more streamlined ticketing, check-in and baggage handling.[62]

3.70   Evidence from the Centre for Asia Pacific Aviation indicated that about 20 per cent of regional aircraft loads are generated from linking flights with the group or through interline partners. This enhances the airline's marketing capability, broadens the potential market base and enables it to offer more competitive fares on a 'through rate' basis.[63]

3.71   Air Link Pty Ltd confirmed the complementary nature of interline agreements saying that the contribution of regional airlines to the passenger numbers of major domestic airlines is up to 20 per cent.[64]

3.72   While Rex did not have a bilateral interline agreement with Australia's major carrier Qantas, it did have such agreements with 19 international airlines.[65] Rex told the committee that it wanted interline agreements with domestic carriers because they had the potential to increase revenue up to 30 per cent:

> The main reason we need the interline is the estimate that somewhere between 10 per cent and 35 per cent of our revenue would be made up of interline if we had worthwhile interline on the domestic trunk routes.[66]

3.73   Brindabella Airlines told the committee that its alliance with Qantas was essential to its success in providing RPT services.[67]

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61   Productivity Commission, '*International Air Services*', Report No. 2, 11 September 1998, p. XV; '*Code Sharing, Issues and Solutions from the Perspective of Leading Underwriters and Aviation Counsel*', March/April 2000, p. 4., www.baig.co.uk, last accessed 1 August 2003.

62   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. 25.

63   Sydney Airports Corporation Limited, submission no. 158, enclosure Centre for Asia Pacific Aviation, '*Airport Charges for Regional Airlines at Sydney Airport*', p. 9.

64   Air Link Pty Ltd, submission no. 94, p. 4.

65   Regional Express, transcript of evidence, Sydney, 8 May 2003, p. 558.

66   Regional Express, transcript of evidence, Sydney, 8 May 2003, p. 556.

67   Brindabella Airlines, transcript of evidence, Wagga Wagga, 7 May 2003, pp. 450, 460-461.

3.74   Qantas told the committee that it offers interlining arrangements to its affiliates and it is working to extend electronic ticketing to its affiliates.[68]

3.75   Underlining the importance of alliances in regional air movements, BTRE said that in 1997 just over half of the regional airlines had an alliance with one of the domestic airlines - then Qantas and Ansett. These airlines carried 97 per cent of the regional passengers. The remaining 21 non-aligned airlines carried only three per cent of regional traffic. Airlines with an alliance with a domestic airline operated on 84 per cent of regional routes.[69]

3.76   The committee considered it important for regional carriers to gain access to a major airline's computer reservation system, technical and information technology support, through-ticketing, on-carriage to and from trunk services, ground handling and ramp handling services and terminal facilities. This access is best achieved through the negotiation of some type of agreement with other carriers.

Computerised reservation systems

3.77   The committee was told that for an airline to have reasonable exposure in a computerised reservation system environment it should participate in a at least three computerised reservation systems. For the same airline to receive bookings from travel agents that use computerised reservation systems it would need an International Air Transport Association airline designator, and hosting on a central computer.[70]

3.78   The cost of building the necessary computer links, being listed on a computerised reservation system, and transaction costs can be high. One witness told the inquiry that it cost around $50 000 to build the necessary computer links to enable the systems of both the major and minor airline to communicate with one another. The owners of these reservation systems charge an access fee and a transaction fee.[71]

3.79   The committee noted that the lack of compatibility between computerised reservations systems makes the cost of being a member of multiple systems even more expensive.

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68   Qantas Airways Limited, transcript of evidence, Sydney, 8 May 2003, pp. 476-477.
69   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. 25.
70   Air Link Pty Ltd, submission no. 94, p. 2; Brindabella Airlines, transcript of evidence, Wagga Wagga, 7 May 2003, p. 461.
71   Regional Express, transcript of evidence, Sydney, 8 May 2003, p. 565.

3.80   One impediment to small operators listing on computerised reservations systems is the potential for some travel agents that are owned by major airlines giving priority to companies in their own network over other airlines.[72]

3.81   Paul Rees gave a note of caution saying that it is possible for a small regional carrier to be listed on 'page 2' of a computerised reservations system. Placed on 'page 2', it was possible for the travel clerk to easily overlook a competitive regional carrier if they did not look beyond the first page.[73]

3.82   The AAA told the committee that in 1993 the then Trade Practices Commission granted the two of the global computerised reservation systems, Galileo and Sabre, an exemption from the restrictive trading provisions of the Trade Practices Act. The exemption was allowed on the condition that a code of conduct applied. The code of conduct was intended to enable third level operator services to be displayed alongside the services of the larger competitor.[74]

3.83   Historically, Australia's largest domestic airlines had ultimate control over these computerised reservation systems. The authorisation for the code of conduct arrangement expired in 1997 and it has not been renewed.[75] The Australian Competition and Consumer Commission advised that under these circumstances the normal provisions of the legislation apply.[76]

3.84   There is also a code of conduct for computerised reservation systems drawn up by the International Civil Aviation Organisation (ICAO). Australia is a signatory to the ICAO conventions. This code states that an ideal computerised reservation system should have a visual display that is fair, non-discriminatory, comprehensive and neutral. It should not favour particular airlines or airports. It should list flight options according to objective criteria, such as minimum elapsed flight times, direct flights and those with minimum intermediate stops preferred.[77]

3.85   The committee believes that a competitiveness issue has emerged with computerised reservation systems, particularly those operated by the larger airlines and by travel agents linked to major airlines.

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72   Macair Airlines, submission no. 76, p. 5.

73   Paul Rees, transcript of evidence, Wagga Wagga, 7 May 2003, p. 466.

74   Australian Airports Association, submission no. 70, p. 6.

75   Australian Airports Association, submission no. 70, p. 6.

76   Australian Competition and Consumer Commission, communication with secretariat, 18 August 2003.

77   Australian Airports Association, submission no. 70, p. 6.

3.86   The committee considered that the interoperability between major carriers, travel agents and regional airlines could be improved in the area of computerised reservation systems. This view was based on evidence that the current market environment could be contributing to restrictive trade practices. Improving the interoperability of players would provide regional airlines greater market access.

3.87   The committee considered that the competitiveness of computerised reservation systems warranted investigation and that appropriate action should be taken if necessary.

Recommendation 1

3.88   **The committee recommends that the Australian Competition and Consumer Commission:**

- **Investigate the anti-competitive behaviour of the operators of computerised reservation systems as it affects regional airlines;**

- **Report its findings by the end of 2004; and**

- **Take action against any party found to be abusing its market position with regard to the operation of computerised reservation systems.**

Access to finance

3.89   Regional aviation businesses need finance to expand and improve the levels of air services to regional and remote communities. The availability and cost (interest) of that finance are some factors that limit the ability of small operators to expand their market services and achieve economies of scale.[78]

3.90   Macair and Airnorth Regional told the committee that undercapitalisation contributed to the failure of many regional airlines. Small regional operators do not have the size to absorb large unexpected changes in their costs or revenues. To survive, an aviation business should be of sufficient size and have a number of contracts and a spread of business interests.

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78   South Australia Government, submission no. 148, p. 11; Regional Aviation Association of Australia, submission no. 93, p. 6; Airnorth Regional, submission no. 102, p. 11.

Each of these revenue earning centres should be independently strong to enable the organisation to cross-subsidise its activities during difficult times.[79] Australia's largest airline Qantas uses this business model and cross-subsidises its regional services as part of its network economics.[80]

3.91   Smaller regional airlines experience difficulties obtaining loan or debt finance. Unlike their large counterparts, such as Qantas, small airlines are generally unable to draw on loans from overseas sources at low rates of interest. Small regional airlines may have to resort to a finance company with higher rates of interest. They may also face even higher interest rates because they are assessed as a higher risk of not meeting repayment obligations.

3.92   There are a number of reasons that lending institutions do not generally consider small airlines to be attractive investments. Small airlines offer relatively low potential returns stemming from their route low capacities, the lack of secure cash flow, the high operating costs and the variability and uncertainty of future.[81]

3.93   Island Airlines Tasmania told the committee that it was difficult to obtain finance for an aircraft to service Flinders Island. Flinders Island is a marginal route and has a high turnover of airlines serving it. In addition, the general downturn in the world aviation industry, followed by the 11 September 2001 terrorist attacks in the United States, has made the finance market very sceptical about the aviation industry.[82]

3.94   A further change in the industry is the ownership of aircraft. Traditionally, airlines have owned their aircraft. Now, it is becoming more common for airlines to lease aircraft. BTRE reported in 2000 that more than 25 per cent of the regional airline fleet was leased.

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79   Macair Airlines Pty Ltd, submission no. 76, p. 4; Macair Airlines Pty Ltd, transcript of evidence, Brisbane, 12 June 2003, pp. 598-600; South Australia Government, submission no. 148, p. 11; Airnorth Regional, submission no. 102, p. 12.

80   Qantas Airways Limited, transcript of evidence, Sydney, 8 May 2003, pp. 474, 478.

81   Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, pp. 639-640; Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. 62-63.

82   Island Airlines Tasmania Pty Ltd, transcript of evidence, Tullamarine, 26 February 2003, p. 282.

3.95   When an aircraft is leased, there is no large initial cash outlay, and instead payments are made throughout the lease period. Consequently, airlines have to match revenues and outlays each year. Lease payments must continue to be met regardless of passenger numbers or services offered. In this case, an airline is more likely to experience severe financial difficulties, or even go bankrupt, in years when it experiences a downturn.[83]

3.96   The lack of finance and sufficient depth in a regional airline can have an influence on the airline's ability to deal with unforseen unavailability (unserviceability) of its aircraft. Tasair said that its ability to meet peaks in demand with the right type of aircraft was a reason for its success in the industry.[84] However, if an airline does not have sufficient aircraft, or other options such as a colleague airline, as a backup, its consistency of service delivery will suffer.[85]

Possible solutions

A community airline cooperative

3.97   Edge Aviation and Paul Bredereck independently proposed a community airline cooperative for smaller regional communities. The cooperative would service marginal air routes that are not serviced by a commercial operator. It was suggested that the cooperative would own its own aircraft, and the government could provide some seed finance to assist the cooperative to become established.[86]

3.98   Some states and territories already subsidise marginal or unsustainable air routes. For example, the Queensland Government has a policy of ensuring all communities are within 200 kilometres of an air service.[87] The concept of an airline cooperative would be used for those states and territories where subsidies are not available.

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83   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', p. 63; Macair Airlines Pty Ltd, submission no. 76, p. 5.

84   Tasair Pty Ltd, submission no. 35, p. 1.

85   Macair Airlines Pty Ltd, submission no. 76, p. 5.

86   Paul Bredereck, submission no. 42, p. 3; Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 646; Paul Bredereck, communication with secretariat, 16 June 2003; Edge Aviation, submission no. 65, p. 12.

87   Queensland Government, transcript of evidence, Brisbane, 12 June 2003, pp. 677-678.

3.99   Champions of the Bush supported the concept saying:

> [the Bendigo Bank model] … is a very interesting model and one
> which, I think, is certainly worth pursuing.[88]

3.100   Island Airlines Tasmania offered words of warning regarding a
         community airline. It stated that for a community airline to survive, it
         needed more than just community support. For the concept to be
         successful the community would have to know about running such a
         business:

> … It gets down to a critical mass of passengers … There needs to be
> a commitment and ownership by the community itself saying:
> 'This is our airline. We will send our freight with them even
> though it will cost us 2c a kilo more … So there needs to be almost
> a Bendigo Bank type involvement … there are a lot of traps …
> Setting up an airline is not just a matter of a group of people going
> out there and getting an air operator's certificate, just like you
> cannot just go and set up a bank … people find they suddenly
> need equity capital and that sort of thing … regional airline
> operators such as me will have to become a lot more community
> involved and will have to diversify, because it will be hard for one
> community to support one airline operator.[89]

3.101   DOTARS considered that the idea of a community owned airline 'has
         prospects'. However, it was noted that the success of an idea depended on
         community patronage of the airline.[90]

3.102   The committee noted that Commonwealth financial assistance to the
         industry has been forthcoming in exceptional circumstances – notably
         following the September 2001 terrorist attacks, and the collapse of Ansett
         in 2001-02. After the collapse of Ansett the Commonwealth established the
         Rapid Route Recovery Scheme to provide assistance to domestic carriers
         to enable the restoration and maintenance of air services to regional
         communities affected by the collapse. The program was designed as a
         short term, transitional response to the sudden impact of the Ansett
         collapse and has since expired after assisting about 18 operators.[91]

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88   Champions of the Bush, transcript of evidence, Tullamarine, 26 February 2003, p. 218.
89   Island Airlines Tasmania Pty Ltd, transcript of evidence, Tullamarine, 26 February 2003,
      pp. 294-294.
90   Department of Transport and Regional Services, transcript of evidence, Brisbane, 12 June 2003,
      p. 651.
91   DOTARS, submission no. 81, p. 7.

Government programs

3.103   However, the provision of seed funding to assist the establishment of community cooperative airlines is a more commercial issue and one that the committee sees is not the direct responsibility of the Commonwealth. The committee notes that there are a range of competitive industry development grants operating and suggests that applications to these programs would be more appropriate.

3.104   The committee considered that there were other policy options that improved the financial attractiveness of smaller regional airlines. While seat subsidies were one solution proposed to supporting regional air services, other evidence said that it was preferable for government to provide assistance to a route rather than a particular airline.

3.105   In this regard, the committee noted that some state governments regulate routes. In the case of New South Wales, this can take the form of licensing the route to one operator for a low nominal fee. In the case of Queensland, it takes the form of competitive tendering for the provision of air services on a particular route for a period of time.

3.106   The committee noted that the Commonwealth's Sustainable Regions Program, through the action plan accompanying the Regional Business Development Analysis, addresses a number of impediments to stronger growth in regional Australia. Amongst the impediments identified in the action plan is the limited access that small and medium regional enterprises have to finance.[92]

3.107   The committee recommends that small and medium regional aviation enterprises utilise the action plan accompanying the Regional Business Development Analysis to improve their access to business and management skills training (see Recommendation 2).

Business skills of small operators

3.108   The evidence indicated that the difficulties of some regional airlines arise from poor commercial decisions.[93] This often results from a lack of management expertise.

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92   Anderson, J., Minister for Transport and Regional Services, media release, '*Minister Receives Action Plan for Regional Business Development*, 7 July 2003, http://www.ministers.dotars.gov.au, last accessed 14 August 2003.

93   Department of Transport and Regional Services, submission no. 81, p. 4.

3.109   The committee was particularly interested in improving the business prospects of the smaller regional airlines because they are the ones that service many regional and remote communities. The existence of these commercial operations is essential to the social and economic development of these communities.

3.110   In a business environment that is changing rapidly, life-long learning or continuing education will help firms to remain competitive.

3.111   Management decisions rely on a set of generic business skills and other skills that are particular to the aviation industry.

3.112   Generic management skills relate to business planning, marketing, financial and risk management, quality management, customer relations management, and knowledge and information management.

3.113   Management decisions needing more specific industry knowledge relate to aircraft selection, routes, networks and aircraft allocation.

3.114   Paul Bredereck told the committee that lack of basic business skills contributed to the failure of many regional airlines:

> I believe the reason my company [Tamair] went out of business was as a direct result of the inadequacy of some of the smallest of business skills. I had a business that in 10 years was very profitable. It had an average marginal revenue of about 10½ to 11 per cent. In three years, it lost it.[94]

3.115   Randal McFarlane, Managing Director of Macair Airlines said that small operators are enthusiastic at grasping new market opportunities. However, this enthusiasm should be balanced with a full understanding of the implications of their business decisions:

> I think part of the problem is that aviation is an emotional thing— people get the whiff of kerosene, avgas or something in their nostrils and away they go. They think: 'Gee, why doesn't someone fly between here and here. There's no-one doing it. We'd better get a plane and go and do that.' Those people should be discouraged rather than encouraged because, unless the market is really there, it will be a failure.[95]

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94   Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 645.

95   Macair Airlines Pty Ltd, submission no. 76, pp. 4-5; Macair Airlines Pty Ltd, transcript of evidence, Brisbane, 11 June 2003, p. 600.

3.116   He said that it is important for the regional airline to clearly understand what business it is in:

> We are not in the business of flying aeroplanes as such. We are in the business of being in a business, which happens to be an aviation related business, and we will do it the best we can.[96]

3.117   Randal McFarlane went on to say that having a realistic business plan is essential. The business plan must be built around the market in which the airline is operating, and controlling costs tightly whilst maximising yields and revenues. The airline should have an excellent business knowledge. It should demonstrate consistency and reliability in its operation, and offer excellent customer service.[97]

3.118   Airnorth Regional said that a reasoned and long term business plan is needed to ensure the survival of regional airline firms.[98]

3.119   Dick Smith considered that the poor profitability of regional airlines meant that the industry was unable to retain high quality business people. In turn, this impacted on appropriate business decisions and profitability:

> Most of them are not very efficient … because regional aviation for the last 20 or 30 years has not really made any money, the good business people have tended to move to something else … the Monarchs, the Seaviews and the Advances [are] not a good example of a successful business person. If you could somehow get the costs down so that good money could be made, the riffraff quickly cannot compete or they get fined out of existence. You then get the competent business people.[99]

3.120   The committee considered that improving the management expertise of the managers of smaller regional airlines would build their capacity and enable them to respond effectively to opportunities and threats as they arise.

3.121   The committee noted that adequate training can improve business decision-making and avoid a business failure. It can also reduce business hardship arising from factors outside the firm's control or within the control of the firm.

96   Macair Airlines Pty Ltd, transcript of evidence, Brisbane, 11 June 2003, p. 599.
97   Macair Airlines Pty Ltd, submission no. 76, p. 5.
98   Airnorth Regional, submission no. 102, p. 12.
99   Dick Smith, transcript of evidence, Canberra, 4 June 2003, p. 581.

Possible solutions

3.122   Paul Bredereck, Chief Executive Officer of Aviation Australia, told the committee that Aviation Australia offers 30 short courses in management and professional development, in addition to technical training. Some 32 airlines and bodies were receiving this training in Australia. The Queensland Government, Australia's major airlines, aerospace companies and Queensland's universities support Aviation Australia.[100]

3.123   The Commonwealth and state and territory governments provide a range of advice and training programs on setting up, managing and expanding a small business.[101]

3.124   The committee was satisfied that appropriate professional training is readily available to smaller regional airlines. However, the evidence suggested that these resources are not being adequately accessed.

3.125   The committee considered that two key issues are the extent to which appropriate professional training is taken up by smaller operators and how much this training can influence positive outcomes in industry.

3.126   The committee strongly urges the industry association to consider the managerial training needs of its members and initiate a program of ongoing training to assist with this.

3.127   The committee notes that Commonwealth departments provide a range of programs that can improve the commercial knowledge of regional airline operators.

3.128   The committee considered that the relevant Commonwealth departments should work cooperatively with themselves and with the industry associations to improve the business management skills of regional airline operators.

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100   Paul Bredereck, transcript of evidence, Brisbane, 12 June 2003, p. 645; Aviation Australia website, http://www.aviationaustralia.net.au, last accessed 21 July 2003.

101   Bureau of Transport and Regional Economics (2000), Working Paper 41, '*Regional Aviation Competitiveness*', pp. 19, 21-22; Department of Industry, Tourism and Resources '*Small Business*', http://www.industry.gov.au, last accessed 14 July 2003; Australian Bureau of Statistics, '*Characteristics of Small Businesses*', http://www.abs.gov.au/ausstats, last accessed 14 July 2003; Business Entry Point, http://www.business.gov.au, last accessed 18 November 2003.

Recommendation 2

3.129   **The committee recommends that the Department of Transport and Regional Services and the Department of Education, Science and Training in conjunction with the Regional Aviation Association of Australia and other relevant industry bodies:**

- **Identify management training needs of the regional airline industry;**

- **Develop and deliver an awareness program that encourages greater uptake of management training in the industry; and**

- **Develop and deliver a program that improves the business management skills in the industry.**

Skilled labour development

3.130   The committee received evidence that there is a shortage of skilled labour in the regional aviation industry. Skill shortages mainly related to pilots and aircraft maintenance engineers.

3.131   Some of this shortage resulted from 'poaching' by larger airlines. This practice imposed costs on the regional aviation industry in terms of recruitment, training and wages. Higher wages are needed to attract qualified staff to regional locations. In comparison, larger airlines can more easily offer higher wages, additional benefits and offer more attractive city locations.

3.132   Macair Airlines said in its submission that the loss of regional airline flight crew to major airlines, and the associated costs of continual recruitment and training of aircrew, is a factor contributing to the failure of regional airlines.

3.133   Airnorth Regional said that regional airlines carry the cost of training inexperienced pilots because the larger airlines then recruit their trained pilots.[102]

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102 Airnorth Regional, submission no. 102, p. 10.

3.134   Rex told the committee that it has difficulties firstly, attracting qualified engineering staff to its regional location, and secondly, retaining them against competition from other employers, such as Qantas.[103]

3.135   David Miller of Air Link Pty Ltd told the committee that the industry is now proactive with its engineering training. Air Link is committed to developing its staff:

> … in engineering: that is an industry problem. There are a lot of people out there that have got a lot of experience but have not got a licence …We are encouraging them and paying for them to go away to do courses and gain licences, but it is a long process. We also have an apprentice on at the moment, and we will continue to try and foster that aspect of training as well.[104]

3.136   Air Link said that many of its apprentices leave at the end of their training. Ironically, some smaller airlines use the training facilities of the larger airline. For example, Air Link sends its apprentices to a training facility in Tamworth.

3.137   Despite the difficulties of training and retaining staff, Air Link took the view that all airlines in the industry should invest in training engineering staff for the good of the industry.[105]

3.138   Aviation Australia provides a range of aviation related training including training for prospective pilots and aircraft maintenance engineers.[106]

3.139   The committee noted that, in August 2001, the Commonwealth announced that it will spend $4.1 million over four years to expand aircraft maintenance training in regional Australia. The funding will support the development of a new aircraft engineering college at Tamworth Airport called the Australasian-Pacific Aeronautical College.

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103 Regional Express, committee inspection of the engineering facilities, Wagga Wagga, 7 May 2003.

104 Air Link Pty Ltd, transcript of evidence, Sydney, 8 May 2003, p. 549.

105 Air Link Pty Ltd, transcript of evidence, Sydney, 8 May 2003, p. 549.

106 Aviation Australia, '*Courses*', http://www.aviationaustralia.net.au, last accessed 8 August 2003.

3.140   The college is a joint venture between BAE Systems, Eastern Australia Airlines, the New England Institute of TAFE, the Tamworth City Council, the New England North West Area Consultative Committee and the New England North West Development Board. The first students will graduate in 2004.[107]

3.141   Based on the evidence presented to the committee, the shortage of aircraft mechanics appears to have been recognised and is being addressed.

3.142   Commercial pilot training is also available from various firms, but the committee noted that the shortage of pilots and the cost of their training could remain an issue for the regional aviation industry. In 2001, the Commonwealth said this was an issue and that it was examining closely what it could do to assist the industry.[108] However, no new initiatives have been announced.[109]

3.143   The pilot shortage has not been ameliorated by the collapse of Ansett in 2001-02. The Aircraft Owners and Pilots Association of Australia (AOPA) claimed that there are certain impediments to the employment of these pilots elsewhere in the industry. AOPA also said there is the possibility of a shortage of pilots in the medium term because of the cost of training and testing and the complexity of CASA regulations. This complexity of regulations may be deterring new entrants to the industry.[110]

3.144   Apart from statements that pilot shortage is an issue and some anecdotal evidence, the committee found that there was a lack of quantitative and qualitative information on the issue of pilot shortage and pilot retention. The committee considered that this issue required further investigation to determine the extent of the possible problem and to devise an appropriate training response.

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107 Anderson, J., Minister for Transport and Regional Services, media release, '*Federal Government Boosts Aircraft Engineer Training*', 24 August 2001, http://www.ministers.dotars.gov.au, last accessed 8 August 2003; National Office of Local Government, '*National Perspective February 2003*', '*Regional Aviation a Commonwealth Priority*', http://www.nolg.gov.au, last accessed 30 June 2003.

108 Anderson, J., Minister for Transport and Regional Services, media release, '*Federal Government Boosts Aircraft Engineer Training*', 24 August 2001, http://www.ministers.dotars.gov.au, last accessed 8 August 2003.

109 Department of Transport and Regional Services, communication with the secretariat, 8 August 2003.

110 Aircraft Owners and Pilots Association of Australia, communication with secretariat, 8 August 2003.

Recommendation 3

3.145   **The committee recommends that the Department of Transport and Regional Services:**

- **Investigate the issue of pilot shortage in regional airlines;**

- **Report on its findings regarding the shortage of pilots by the end of 2004; and**

- **Develop an appropriate program to expand pilot training in regional Australia along the lines of its program to expand aircraft maintenance training, if a pilot shortage is identified.**