

Submission by Qantas Airways

To
The House of Representatives Standing Committee on Transport and
Regional Services

Inquiry into
Commercial Regional Aviation Services in Australia and Transport Links
to Major Populated Islands

Introduction

Qantas is pleased to be able to submit its views to this Inquiry, one of a number which have been undertaken in recent years at State and Commonwealth level.

This reflects not only the importance of regional aviation in the Australian context but the difficulties inherent in providing safe, reliable and affordable air services to regional and remote communities, and of doing so on a viable commercial basis consistent with realistic community expectations.

Many regional communities depend on services by air to maintain contact with capital cities, and as a platform for increased tourism which represents an attractive option for diversifying the economic base of regional areas.

Over 7 million people travelled on regional air services throughout Australia last year.

Regional aviation has had a chequered history in recent years and airlines continue to find it difficult to conduct profitable services to regional areas. Costs have risen beyond the ability of many airlines to sustain economic operations causing some to cease to exist and others to re-emerge under new ownership.

Notwithstanding Qantas' unique ability in the Australian environment to provide network benefits to consumers across all elements of its business, QantasLink's regional services are required to stand on their own feet commercially.

Qantas is far from immune to the negative influences on regional air routes and currently QantasLink operates a significant number of marginal or loss making routes across regional and rural Australia. QantasLink has worked assiduously to reduce costs, avoiding where possible the need to reduce or eliminate services. Central to this strategy has been the development of affiliate relationships with airlines better suited to lower volume operations.

Role of Major Air Transport Carriers in Providing Regional Services

State of the Industry

While there are some unique challenges at the regional level, there are marked similarities in the financial performance of most regional operators and the rest of the aviation industry in Australia and throughout the world.

Globally, the industry has been in a parlous state for some time, and the events of 11 September only exacerbated a worrying downturn in higher yielding passenger traffic that had been apparent throughout the earlier part of 2001.

Member airlines of the International Air Transport Association (IATA), which account for some 97% of scheduled airline operations throughout the world, lost around \$US12 billion in calendar year 2001, and it appears will lose around \$US6 billion in 2002.

In a recent speech, the President and CEO of the Air Transport Association in the USA identified the fact that over the past fifty years the industry's net profit margin has been one half of one percent, compared to the average for all industries of approximately six percent.

While Qantas remains profitable, with a recently reported net profit of \$428 million in 2001/2002, its return on assets employed is low compared with other major Australian companies.

In 2001/2002, despite improved loads and yields following the collapse of Ansett, earnings before interest and tax for the QantasLink Group amounted to only \$42.5 million or 6.3% of total Group earnings. This result, while an improvement on the prior year which was impacted by high fuel prices and an adverse exchange rate, is below the result from two years ago, demonstrating the challenge that regional airlines face in generating acceptable returns in this volatile and capital intensive industry.

Relationship between the Regions and the Air Transport Sector

The regional tier of commercial aviation can be defined in a number of ways.

Most definitions used in the Australian context exclude core airline operations linking major metropolitan centres on the key trunk routes (eg Sydney/ Melbourne/ Brisbane/ Perth). Services linking major metropolitan centres with rural and regional Australia (eg Sydney-Dubbo) are generally deemed regional as too are a number of air services providing links between our smaller, secondary metropolitan centres (eg Adelaide-Gold Coast).

For a network airline such as Qantas, it is therefore not possible to strictly quarantine regional services from the remainder of the airline. Some destinations, such as Canberra, are served by both QantasLink subsidiary airlines and the core domestic airline. Other routes, which might appear a

natural part of the core network, such as Melbourne-Hobart, are served under the QantasLink brand by B717 jet aircraft.

Although fitting more conveniently under a regional definition, services operated by Qantas' trunk domestic B737 fleet to destinations such as Kalgoorlie, Karratha and Broome, and recently increased frequencies to a number of regional tourist destinations such as Alice Springs and Uluru, are excluded from analyses of QantasLink operations.

In this paper, regional services are generally synonymous with services conducted by QantasLink.

Within this broad definition of regional aviation, the industry structure within Australia can be categorised into three broad groupings:

Major regional airlines:

- QantasLink, operating jet and turboprop services to 55 destinations across all states and territories, including many regional centres
- Virgin Blue, operating Boeing 737s to regional centres such as Coffs Harbour, Launceston, and Mackay
- Regional Express (Rex) operating turboprop services in NSW, Victoria, Tasmania and South Australia.

Medium-sized regional airlines:

This includes many Qantas affiliate airlines, carriers supported by Qantas through various forms of commercial arrangement such as hosting in the Qantas reservation system, provision of ground handling services and participation in the Qantas frequent flyer program.

- Air North, based in Darwin (Qantas affiliate)
- Airlines of South Australia, based in Adelaide (Qantas affiliate)
- Alliance Airlines (formerly Flight West), operating services from Brisbane to Gladstone, Rockhampton and Townsville
- Macair Airlines, based in Brisbane and Townsville (Qantas affiliate)
- Skywest Airlines, based in Perth
- Sunshine Express, based in Maroochydore (Qantas affiliate)

Small regional airlines:

- Aeropelican, based in Newcastle (Qantas affiliate)
- Air Link, based in Dubbo (Qantas affiliate)
- Horizon Airlines, based in Sydney (Qantas affiliate)
- O'Connor Airlines, based in Mount Gambier (Qantas affiliate)
- Northwest Regional, based in Broome (Qantas affiliate)
- Many other predominantly charter operators

Viability of Services at the Regional Level

Decisions as to how to serve different locations are made fundamentally on financial and economic grounds.

Regional market economics are challenging due to the capital intensity, high operating costs and thin margins characteristic of operating smaller aircraft over relatively short distances.

It is important, nevertheless, that Australia maintains a sustainable industry, meeting realistic community expectations on a viable basis. Anything less than profitable operations are unlikely in the longer term to lead to service expansion, job creation and investment.

Seat economics make this a challenge at the regional level. It is a reality of the aviation industry that the smaller the aircraft and shorter the sector length flown, the higher the unit cost per passenger or seat. Regional aviation utilises smaller aircraft operating sectors that are generally shorter than mainline operations. However, market expectations regarding regional airfares are still based on mainline fare levels.

There are numerous examples of cost relativity between regional and mainline air services for a comparable sector and seating configuration. For example:

- Two pilots are required on a 36-seater regional aircraft, the same as on a single class 260 seat mainline aircraft. The resulting crew costs per seat are almost four times greater for a regional operation, even after adjusting for typically lower regional rates of pay.
- Maintenance costs per seat on a 36 seater regional aircraft are more than double those on a 260 seat mainline aircraft.
- Aircraft ownership costs are more than 50% higher on a per seat basis for a 36 seat regional aircraft than for a 260 seat mainline aircraft.

- Landing and en route charges are more than 40% higher on a per seat basis for a 36 seat regional aircraft than for a 260 seat mainline aircraft.

Overall the total cost per seat of a regional service is considerably higher than for mainline operations on a comparable sector. When the longer sector lengths of mainline operations are taken into account, the cost relativities are even greater. Yet passenger expectations regarding regional airfares remain influenced by the pricing of mainline services.

Regional Presence

QantasLink is now the only regional airline group with national reach and only QantasLink operates aircraft types capable of providing for the movement of larger numbers of passengers, including overseas tourists, between all major domestic and international gateways and regional ports.

Further detail on Qantas' regional operations is outlined at Attachment A.

Support for Smaller Regional Carriers

In conjunction with its move to larger aircraft, QantasLink has been active in strengthening its network of affiliated airlines, capable of operating services into regional communities more suited to their aircraft size and cost structure.

Qantas actively supports these airlines through a variety of commercial arrangements, assisting in product distribution (most prominently "hosting" in the Qantas computer reservations system), participation in the Qantas Frequent Flyer program, marketing, ground handling (including passenger check-in, baggage handling, tarmac marshalling, load control etc) and in providing operational support.

The airlines with which QantasLink is currently affiliated are listed at Attachment B.

Adequacy of Regional/Rural Air Services

In overall terms, airline capacity and passenger numbers carried on regional services have continued to grow, despite the financial problems of a number of regional carriers.

Reasons for the difficulties encountered by regional carriers differ. The larger Ansett affiliates, Kendall, Hazelton and Skywest were casualties of the demise of their parent, but others, especially smaller operators or those with a high dependence on services to smaller population centres, can probably claim their downfall was due more to failing markets than to failing operations.

Improved roads, greater access to cars and relatively high regional airfares due to costs, especially for short distance operations, have lessened the need and attraction for air services to some smaller communities, especially where distances to larger population centres are not great.

For example, the driving times from Inverell or Glen Innes to Armidale, from Casino or Lismore to Ballina, from Toowoomba to Brisbane, from Grafton to Coffs Harbour, from Maryborough to Hervey Bay, from Blackwater to Emerald, from Taree to Port Macquarie, and between Longreach, Barcaldine and Blackall are no longer than those with which residents of outer metropolitan areas regularly contend in travelling to and from capital city airports.

To more remote communities, the economic viability of air services has in some cases disappeared. Costs, such as fuel, salaries, insurance, landing and airport charges continue to rise and make fare levels, that are a financial necessity to an airline, appear higher to a potential passenger accustomed to pricing of lower cost mainline services. When rising costs are combined with shrinking populations in an already small base market, the consequence is not surprising.

In these circumstances, regional communities have to be realistic about their ability to sustain air services on specific routes even when in the past they have been provided with such services. Government policy makers also need to consider whether demands upon them to assist in the maintenance of services on failing routes are in the best interests not just of the communities directly involved but the broader regional market.

Regional Hubs

Regional hubs are sometimes quoted as a solution for the decline in direct air services in some regional communities - the aim being to link smaller feeder services to a regional centre of sufficient size to sustain direct and regular air services to capital cities. Qantas agrees that regional hubs have merit in some limited circumstances but does not see their deliberate development as a viable solution to declining services in most regional centres.

Facilitation of passenger connections between QantasLink and some of its regional affiliates has given rise to the establishment of small-scale hubs at Tamworth in NSW (Air Link to/from QantasLink) and Broome in W.A (Air North and Northwest Regional to/from QantasLink).

The Role of Governments

Industry Regulation

Given that state governments have regulatory jurisdiction over intra state air routes it is unlikely that Australia will see a uniform approach adopted to the licensing of regional operators including the allocation of capacity and routes. For an airline such as Qantas this is a barrier to efficiency, but one which is nevertheless manageable.

Of greater concern is the need to ensure that within state jurisdictions, markets are deregulated as far as possible to prevent route licensing decisions impeding efficient airlines in their desire to serve growing markets. It is Qantas' view that only in this manner will it be possible to establish a long-term viable regional aviation industry in Australia.

There may be no alternative to regulatory intervention in some failing markets if governments decide community aspirations must be met – but only in situations where a single airline operates the route in question.

Qantas is of the view that if state governments wish to persist with route licensing it should be applied only on routes which are clearly incapable of sustaining more than one operator. It needs to be clear beforehand that without a government decision to allocate specific routes to one carrier, free from the threat of competitive market entry, the communities involved would either have only limited or, more likely, no air services.

The current Queensland model of route allocation is built on a number of these features. The Queensland Government has determined that on a range of relatively thin rural and remote intrastate routes to 26 communities one carrier only will be licensed to operate. The carriers concerned (QantasLink and Macair) have entered into five-year contracts, and in return for accepting conditions relating to timetables and airfares, will share a \$7m annual subsidy.

Qantas supports this model as an efficient and commercially realistic competitive tendering process for routes that would otherwise be without an air service.

Industry Assistance

Broadly speaking, Qantas does not support the provision of financial assistance to airlines unless, at the regional level, this is necessary to encourage airlines to serve communities which, without such support, would have no access to air services.

As with regulatory intervention, Qantas believes that if governments do see the need to intervene to maintain a particular regional operation, assistance should be offered only if there is clear evidence of market failure on the specific route, and should be tied to ensuring the maintenance of a minimum level of service by one carrier on that route.

Levels of assistance needed to meet this objective should be identified in the market place.

Taxes and Charges

It is Qantas' view that any remaining State taxes should be removed. Although not the only factor in decisions to serve particular routes, their removal will be of benefit to airlines in helping to establish viable routes.

Qantas supports airport charges being collected on a per passenger basis, rather than on a formula related to an aircraft maximum take-off weight (MTOW). This provides transparency of airport charging as it allows these costs to be shown separately on the passenger ticket. It assists airlines which may operate from time to time with light loads as the collection is based on the number of passengers carried, not the weight of the aircraft employed. It also cushions an airport from the impact of one operator withdrawing services as the passenger load is typically reaccommodated on the remaining services of other operators.

The Ansett levy, which is collected from all QantasLink passengers at \$10 per ticket, is not required from passengers travelling on aircraft with 16 seats or less. This directly disadvantages QantasLink passengers.

Regional Infrastructure

Governments must be actively and directly involved in the work required to maintain, support and develop regional airport infrastructure. Such burdens are often beyond the means of local authorities.

The Minister for Transport and regional Services has announced that the Federal Government will provide \$13m in 2002/2003 to support regional air services and general aviation.

\$6m of this is a subsidy to regional airlines for Airservices Australia en route charges, but only applies to aircraft under 15 tonnes MTOW. This directly benefits the 36-seat Saab fleet of Regional Express (Rex), but does not apply to the QantasLink 36-seat Dash 8 fleet, as this aircraft has an MTOW of 15.65 tonnes. This discriminatory policy imposes additional costs of \$3.6m per annum on the QantasLink Dash 8 operation, which impacts on route viability and distorts the competitive playing field.

The Government will support the costs of regional towers with a subsidy of \$7m, but this does not cover the full cost of regional tower operations. The remainder of these costs are hidden in Airservices Australia's charges, the bulk of which fall on Qantas. We believe the entire cost of these towers, the main beneficiaries of which are light aircraft operators, should be a community service obligation, transparently and discretely accounted for in the Federal Budget.

Commercial air services to major populated islands

Qantas endorses the current process of awarding access opportunities to offshore territories by tender.

Policy Conclusions

Qantas takes the view that the policy principles applied by the Commonwealth to regional aviation should be the same as those applied to trunk route domestic and international operations. That is, the focus of Commonwealth regulatory activity at the regional level should be upon safety and operational issues - including the provision of adequate regional infrastructure on a user pays and cost effective basis.

The Commonwealth should resist the temptation to engage in economic regulation of airline activities and, where this already exists, should seek to progressively disengage itself from these processes.

This should be left to the states to determine and implement where there is clear evidence of market failure in the absence of government intervention, and only then when it can be seen that such market failure would see valid and realistic community expectations unfulfilled.

Qantas Airways Limited
12 September 2002

QANTASLINK

Structure

- Qantas' wholly owned subsidiary, QantasLink, encompasses five regional airline entities:
 - Airlink (operated by National Jet Systems)
 - Southern Australian Airlines
 - Sunstate Airlines
 - Eastern Australian Airlines
 - Impulse Airlines.

Fleet

- QantasLink, either directly or through contractual arrangements, provides jobs for more than 2,100 Australians, 1,600 direct and at least 500 indirect (many outside capital cities) and operates three aircraft types:
 - Boeing 717 jets
 - British Aerospace BAe146 jets
 - DeHavilland Dash 8 turboprop aircraft
- There are 63 aircraft in the QantasLink fleet, made up as follows:
 - B717 - 14 (one class with 102, 115 or 117 seats)
 - BAe146 - 17 (two class with 64, 76 or 87 seats)
 - Dash 8 - 32 (one class with 36 or 50 seats).

Service Expansion

- The QantasLink group operates more than 2,750 flights each week to 55 regional destinations, flying more frequently and to more destinations than the core Qantas domestic operation. When, in July 2001, major Queensland operator Flightwest ceased operations followed only weeks later by Ansett and its regional subsidiaries, QantasLink and other regional operators mounted hundreds of additional services to provide immediate relief to 25 regional ports affected by these airline closures.

- Nine of the ports previously served by Flightwest and Ansett, in Western Australia and Queensland, have now been added to Qantas' regional network as permanent destinations, and, as of 30 June 2002, are served with a total of 148 services per week.

Qantaslink's contribution to rescuing stranded regional passengers immediately after the collapse of Ansett, Hazelton, Kendell, Skywest etc was to carry more than 4,000 passengers, either free of charge or at highly discounted rates, to a value of more than \$1million.

- In addition to these "rescue" operations, this year QantasLink has expanded its services across the board to better meet the needs of regional Australia. New and expanded operations include:
 - New direct services Hobart-Gold Coast, Adelaide-Gold Coast, Sydney-Rockhampton, Brisbane-Alice Springs, Sydney-Proserpine, Sydney-Mackay;
 - Additional services Alice Springs to Cairns and Broome; Melbourne to Mildura, Canberra, Burnie and Devonport; and Sydney to Albury, Ballina, Coffs Harbour, Dubbo and Wagga.
- This year, an extra six Boeing 717 and five Dash 8-300 aircraft have been added to the QantasLink fleet, providing direct employment for an additional 240 pilots, flight attendants, engineers and operational staff.
- In all, the addition of new destinations, plus expanded flying to/from ports already served, has resulted in a growth of available seat kilometres (ASKs) for the QantasLink operation since September last year of around 28% (August 2002 compared to August 2001). This compares with a not insignificant annual average growth rate of 9% over the preceding 5 years.

Network (destinations added since July 2001 underlined)

- Northern Territory: Alice Springs, Ayers Rock, Darwin, Gove
- NSW: Albury, Armidale, Ballina, Coffs Harbour, Dubbo, Grafton, Lord Howe Island, Moree, Narrabri, Newcastle, Port Macquarie, Sydney, Tamworth, Wagga Wagga
- ACT: Canberra
- Queensland: Barcaldine, Blackall, Blackwater, Brisbane, Bundaberg, Cairns, Charleville, Emerald, Gladstone, Gold Coast, Hamilton Island, Horn Island, Longreach, Mackay, Maroochydore, Mount Isa, Proserpine, Roma, Rockhampton, Townsville, Weipa
- South Australia: Adelaide

- Tasmania: Burnie, Devonport, Hobart, Launceston
- Victoria: Melbourne, Mildura, Mt Hotham (seasonal)
- Western Australia: Broome, Kalgoorlie, Karratha, Newman, Paraburdoo, Perth, Port Hedland.

Operational Bases

- Newcastle – B717 heavy maintenance facility
- Tamworth – Dash 8 heavy maintenance facility and administration centre
- Mildura – Dash 8 line maintenance facility
- Hobart – crew base
- Brisbane – Sunstate Airlines head office, line maintenance facility and crew base
- Sydney – Eastern Australia Airlines head office, Impulse Airlines/Airlink head office, crew base and line maintenance facility
- Melbourne – crew base and line maintenance facility
- Canberra - crew base
- Cairns – crew base.
- The decision recently to maintain QantasLink's B717 maintenance facility in Newcastle, against strong competing claims from other locations, including Canberra, which had been Impulse's intention prior to its takeover by Qantas, is regarded by Qantas as demonstrating its very strong commitment to regional employment.

QANTASLINK AFFILIATED AIRLINES

- Aeropelican, based in Newcastle
- Air Link, based in Dubbo
- Airnorth, based in Darwin
- Airlines of South Australia, based in Adelaide
- Horizon Airlines, based in Sydney
- Macair, based in Townsville and Brisbane
- Northwest Regional Airlines, based in Broome
- O'Connor Airlines, based in Mount Gambier
- Sunshine Express, based on the Sunshine Coast
- Norfolk Jet Express based in Brisbane.

Affiliated airlines serve approximately 66 additional ports to the QantasLink network and provide Qantas with a significant secondary network.