

THE FUTURE OF ASIAN AIRLINES IN AN OPEN  
INTERNATIONAL AVIATION ENVIRONMENT

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Mr. Chairman, ladies and gentlemen, thank you for inviting me here today to the International Aviation Club of Washington. It is an honor and a pleasure to address this distinguished audience, representing a wide spectrum of organizations involved in international aviation.

Today, I would like to share with you my thoughts on the future of Asian airlines in an open international aviation environment, and China Airlines' corporate strategy to cope with this competitive environment.

1. PROSPECTIVE ECONOMY IN ASIA

Economic growth is vital for air travel growth. A rising world GDP drives boost in air travel by increasing household income and free trade. Therefore, for the first part, I would like to brief you in general about economic development in Asia.

Asian economic development has been hit by the financial crisis since 1997. However, various signs show that the worst of the crisis is dissipated, as most East Asian economies are bottoming out. The growth rate of East Asia decreased sharply in 1998 but started to show bright signs at the beginning of 1999. In general, East Asian economies are moving toward a recovery.

According to IMF, the economic growth of Association of Southeast Asian Nations (ASEAN) is much better than in 1998. ASEAN registered a growth of 1.4% in 1999 and an expected 3.6% in 2000, compared with -9.8% in 1998. Overall Asia will grow by 5.4% in 2000, compared with 3.7% in 1998. Although it is too soon to assert the resurgence of overall Asia, potential economic growth of East Asian countries is expected.

Taiwan is the least-affected country during the Asian turmoil because of its sound economic system and measures. Its economic growth rates were 4.6% and 5.5% respectively in 1998 and 1999, and is expected to grow 6.0% in 2000. Taiwan's experiences suggest the speeding up of economic reforms by creating a level playing ground for businesses is a very important step to strengthen economic competence.

The Asia-Pacific aviation industry was negatively impacted by the Turmoil. IATA lowered the average 5-year passenger growth rate from 7.7% to 3.6% in 1998, and from 9.0% to 6.3% for cargo growth.

Upside risk is that Asia traffic rebounded in most markets. According to Japan National Tourist Organization, Japanese passengers start to go back to Asian destinations and resume to the level of 1997 since August 1999. Taiwan outbound passenger growth rates also increase from -4.1% in 1998 to 10.93% in 1999. According to IATA, the passenger growth rate in Asia is expected to reach 4.1% and 4.8% in 1999 and 2000 respectively. And air cargo market is growing much faster than any other sector of the aviation industry. Global trade shipped by air is forecasted to post annual growth rate of 6.6%. Asia-related airfreight market growths will lead the rest of the industry. According to IATA forecasts, the average annual growth rate for next five years of Asia and Taiwan cargo demand is 5.3% and 8.8% respectively. With the gradual dissipation of the effects of financial turmoil, we expect cargo market demand will grow even faster.

Another good news is that Asian airlines now are less market-share driven and more profit minded as

a result of the crisis. In some way, the crisis has made airlines more cautious to expand capacity in response to traffic growth.

The downside risk is higher jet fuel price. High fuel price will inevitably pressure airlines' profitability. With resuming demand, disciplined capacity and effective hedging, I believe Asian airlines shall be able to reduce such adverse impact to some extent.

By the way, let me mention WTO's impact on Asia. Increasing economic integration will accelerate foreign direct investment in overall Asia where includes countries and areas that are at various levels of development and diversity. Although member countries are obliged by the rules to remove 'ff and liberate domestic markets, WTO also help enhance regional tan trade and investment rationalization. Keener competition, the side effect, will pressure local enterprises adversely. For industries with competitive advantages, export growth will further increase. Industries with competitive disadvantages will soon disappear in this new business environment. Financial markets will tempt to volatile. And governments need advanced measures to cope with changing economic dynamics. We believe the impact of WTO entry on economic reform in member country is more important than the pure trade effects of reducing tariffs and other market barriers.

Taiwan has worked very hard over the last decade toward WTO membership. In order to achieve this goal, the government has progressively improved market access, eliminated WTO-inconsistent measure as well as revamped the domestic trade regime to make it more business and investment friendly. Concerning airline industry, cargo-forwarding business, CRS & ground handling will be open for investment in Taiwan once membership allowed. Current cross-strait relationship is also expected to be more moderate with both China and Taiwan's WTO memberships. As we can foresee, interaction and trade between Taiwan and China shall accelerate.

## 2. GLOBAL AIRLINES COMPETITION

Liberalization and privatization, two closely linked drivers of globalization, have been dominant economic trends over the past decade. For the second part, I would like to discuss about the globalization in the airline industry from both aero-political and commercial aspects, especially focus on Asia.

All of us know that the airline industry all over the world has been going through some turbulent changes. These changes have been driven by commercial and financial imperatives **and** by consumers' demands for greater safety, convenience and value, and more access to more nations. As a result, the process of globalization, a phenomenon that we've observed in telecommunications, banking and many other industries, is now well underway in the airline industry, especially in the Asia-pacific region.

The APEC (Asia Pacific Economic Co-operation) Air Services Group first proposed air service liberalization initiatives in 1997. 33 of the world's 50 largest airlines were from APEC economies in 1997, for which carried 789 million passengers and generated combined revenue of US\$ 172 billion.

One of the most significant decisions ever to be implemented affecting the region's airlines was voted at the APEC group summit in Auckland last September. Leaders approved a draft proposal which will take the region firmly down a path towards open skies and a free aviation market. This follows the ratification of an increasing number of more liberalized bilateral air treaties between Asian countries and the US, and the initiation of significant steps towards open skies by some countries which have previously shunned the prospect. In which two of the eight specific steps to take the region towards the open air services market are of top priorities:

- Eliminating restrictions on air-related services such as ground handling and computer reservations and removing barriers to airfreight services providers, whose capacities and rates are currently set by governments.

- Allowing multiple airline designations, increasing competition in domestic and international markets and permitting airlines to expand cooperation with each other through ventures such as code-sharing.

It is encouraging that APEC economies agreed to take on liberalization measures. Leaders recognize the benefits of freeing up air services. Opportunities to trade and travel are expanded, opening the way for the economic growth which is at the core of APEC's overall objectives.

During the process of liberation and globalization, safety issue is another major concern. Increasing consolidation and alliances in the airline industry also implies the management of air safety needs to shift from individual airlines to alliance groups. Governments and carriers must ensure that there will be a balance between increased service, environmental protection, safety and security.

The aviation industry contains a basic paradox: it has to be highly conservative, to ensure the aircraft and infrastructure are safe and reliable, but also dynamic, to incorporate the new technologies needed to accommodate to persistent growth in air transport demand. It usually requires high investment to develop new technology on aircraft design and launch, and whereas to improve the efficiency. However, new technology is affordable only if it is financially justified. We believe future of the airline industry is being shaped more by the demands of the market, and less by the possibilities of technology.

Technology has already brought us CRS in 1960-70s, one of the most progressive and successful applications of computer in airline industry. About 80% of airline tickets sold are through CRS nowadays. Nevertheless, CRS now is challenged by even more advanced ticketless travel, on-line booking and E-commerce because of higher distribution costs including commission, ticket processing etc., and also because of the merging of WWW and internet which reshape the consumer behavior for airlines. E-commerce can help airlines sell directly over the internet and get revenue information quickly. The cost for selling a ticket on the internet is much cheaper than that through a travel agent. Most important of all, the internet gives customers access to airline booking information 24 hours a day. We believe that airlines or other travel-related web sites will continue to draw traffic away from the agencies as they offer more products, not only in the States but also all over the world.

The way we conduct business is greatly influenced by customers' needs. Passengers' preference on new and wide-body Jetliners and fruitful supply in Asia drove carriers pursuing for more modernized aircraft. Because of operation efficiency, fast-growing traffic, and especially of keen competition concerns, Asian carriers are long known for young and modernized fleet. Fleet planning is the core of an airline's strategy and for its survival. Fleets may be projected to cope with expanding demand or improved market share. Alternatively, it may be deemed necessary to replace part of existing fleets because of high operating costs, unacceptable noise, inadequate passenger appeal, inefficient utilization, or merely aimed to reduce fleet age. Nevertheless, airlines benefit from fleet modernization and simplification on cost, operation efficiency and safety concerns.

Burgeoning market growths in Asia have also made airport infrastructures fail to match in the past. Shortage of airport slots in major regional airports such as in Japan, Hong Kong, Taiwan etc. in turns incurred higher users' costs for carriers. To comply with the fast-growth demand and vast opportunities, Asian governments, such as Taiwan, Hong Kong, China, Malaysia etc., have invested tremendously in airport infrastructures. Therefore, concerns on airport slots and costs are expected to resolve.

Another remarkable trend is consolidation. With emerging globalization and regional integration, keener competition is expected. Airlines have realized that it is impossible to be effective on a global scale by acting alone. Alliance became prevailing. However, commercial air transport consolidation does not necessarily mean the disappearance of an individual carrier's identity but rather its participation in a large mega-airline partnership, so called strategic alliance. It is believed that it should provide the benefits of scope and scale that are associated with a broader network which could create great operating leverage for some Asian airlines which are smaller than their alliance partners. Alliances allow

airlines expand their market and service more destinations for customers without huge capital investment. Thus airlines can provide more convenient passenger and cargo services to their customers such as through-fare tickets and better FFP, etc. As the world is becoming global and the competition in this industry's has been intensified, those non-allied airlines might be hard to compete in an international aviation market.

In my opinion, airlines code-sharing will continue to be a prevailing form of cooperation as it is the most cost effective way to enter into new markets within regulatory restrictions. In the face of economic uncertainty and increasing competition in Asia, allying with partners for code-share flights, joint cargo services, combined marketing efforts, shared airport lounges and other facilities are tempting alternatives.

During the evolution of globalization, the disputes have occurred not only on aero-political side but also on commercial side within Asia-pacific or across the Atlantic. However, I believe the trend of globalization is no return. The international aviation industry should be like any other great global industry. No restrictions based on narrow nationality, no obstacles to serving people wherever and whenever there is a demand which we believe we can satisfy. We are prepared for progress **and** globalization not by being radical but by being realistic. That progress will only come if the legitimate interests of both sides of the argument are met. Therefore, we strongly recommend that the continuous dialogues between carriers all over the world are necessary for mutual understanding and consensus.

### 3.TAIWAN AND CHINA AIRLINES' STRATEGY FOR GLOBALIZATION

Concerning the development mentioned above, how to reposition and restructure ourselves for survival and growths become the most important issue for economies and industries within the region. Therefore, following, I would like to turn to Taiwan's policy and China Airlines' strategy for globalization.

For the past thirty years, Taiwan has made remarkable progress in economy, and has developed into a major economic force not only in Asia but also around the world. Since the breakout of the Asia economic turmoil, Taiwan's status remains much more prosperous compared with other Asian countries. This can be attributed to the sound economic fundamentals and the steady pursuit of economic reform for liberalization and political stability.

Despite of the economic achievements, Taiwan's exceptional international situation would somehow prevent us from expanding external relations. Such political barrier is the major constraint in our pursuit of international dialogue and participation, even for the airline industry's development. However, to endeavor to the fair competition, international cooperation and standardization, the Civil Aeronautics Administration (CAA) of Taiwan continuously and actively takes part in all civil aviation international organizations to promote international contacts based on the principle of equal and reciprocity.

Civil aviation is a highly sophisticated, internationalized, service oriented professional. Its development has been significantly affected not only by external relations but also by the country's policies and domestic infrastructure. When the government of Taiwan visioned the liberalization trend and adopted Open Sky policy in 1987, it has also taken many compatible measures to cope with the demand not only from aviation but also from overall economic and trade growth.

Taiwan government distribute tremendous resources and efforts to accelerate major airports improvement project which are part of the Six-year National Development Program, to complete the airport automation project and to promote the Taipei International Airport as an Asia-pacific Air Transport Hub.

In addition to the hardware improvement, the CAA of Taiwan also strive for software advancement to meet the international standards and to counter the aviation environment challenges, such as requiring national carriers for certification under ISO9000, conducting various flight-safety and standardization with the assistance of the US FAA, restructuring the aviation infrastructures for safety purpose. An independent organization, Aviation Safety Council, was established in 1997 as a neutral safety moni-

toring and management organization. It also aims for closer cooperation with other international counterparts, such as NTSB, TSB (Transportation Safety Board) in Canada, AAIB (Air Accidents Investigation Branch) in UK and so on. The CAA also thoroughly studies and modifies the civil aviation laws and regulations to meet the needs of modern aviation industry, and to establish a sound regulatory system.

In China Airlines, considering the market opportunities and challenges, we have taken a few important actions over the past several years, such as made a face-lifting by launching the new CIS “The Pink Plum Blossom”, restructuring and privatizing the company for operation efficiency and productivity improvement, merging two subsidiary airlines to establish a regional feeder services, and campaigning our cross-century strategic plan since 1996. Now I would like to share with you about China Airlines’ corporate vision and missions.

China Airlines is the leading commercial airlines for passenger and cargo in Taiwan serving 38 passenger flight destinations, 20 cargo flight destinations in 21 countries since 1959, 40 years ago, and grows into a sizable international operators with US\$ 2.2 billion of revenues in 1999 which approximately ranks 37 worldwide. China Airlines operates over 300 international passenger flights per week serving approximately 8 million passengers around the world. The cargo business which ranked top 10 worldwide operates 41 weekly international freighter flights and shipped close to half of a million tons of cargo and mail in 1999 with a fleet of 11 B747 freighters. At the moment, we have a fleet composed of 51 aircraft, of which with an average age of only 6.7 years. Mandarin Airlines, our 90%-owned subsidiary, as regional feeder which can help building our Taipei-centered network as a strong hub for domestic, East-Asia and Transpacific markets.

Above and beyond, China Airlines also involved other various aviation-related ventures including catering services, ground handling **services**, engine and maintenance, automation distribution, and our most recent venture in the Taipei International Airport’s **air cargo terminal** business.

With these profound aviation substance and experience, last year, China Airlines formulates a company vision “To be the most reliable airline” in line with essence of safety, services, market position and competitive advantages. To achieve this vision, our strategic objectives and action plans can be summarized as following:

Firstly, fleet rationalization. To facilitate safety operation and benefit long-term bottom-line and profitability, we have a carefully calibrated fleet plan concentrating on simplification and modernization of the current fleet. We plan to reduce the passenger aircraft types from 7 in 1999 to 5 in 2000, to 4 in 2003 and to only 3 by 2007. Similarly, we intend to focus our freighter fleet around B747-400 exclusively. The average age of the fleet then will be reduced to below 6 years. We believe the program will enable China Airlines to increase overall competitiveness, cost effectiveness and most important, the safety.

Secondly, to continue focus on flight safety and training, we will continue to focus strongly on our flight safety and training both from operations and maintenance sides with the assistance from consultant which we recruit from external. We have implemented a number of steps to enhance our safety procedures which mainly concentrating on training, standardization and discipline.

Our maintenance facilities are fully equipped, most sophisticated and one of the best in the region. We have just completed in last year a US\$200 million 3-Bay hangar, together with the existing 2-Bay hangar, which allow us to service up to 7 widebody aircraft simultaneously. We provide third party maintenance work for many airlines, for US carriers such as FedEx, Atlas, Tower Air, etc. Our E&M division are certified by major regulatory authorities, including FAA, JAA, etc. Our maintenance team is also highly experienced, with over 67% having college degree.

Thirdly, to do what we do the best ‘in terms of network and services. China Airlines will keep strengthening the regional network and developing Taipei as an ideal gateway between the U.S. and East Asia.

And the expected cross-strait direct air link would further intensify Taipei hub's competitiveness. Besides, China Airlines will keep delivering the customer-oriented services and staying in the three classes (F/C/Y) competitive world-class services to maintain our services superiority and to guarantee our services the best among the airline group constantly by standardized training.

Fourthly, to continue growing cargo business. Taking consideration of Taiwan's booming information technology industry and regional economic recovery, we believe the double-digit cargo growth rate may sustain and intend to take advantage of growing our cargo capacity. Our recent order for up to 13 firm/4 option Boeing B744F freighters is in line with this concept, although the delivery will be extended from July 2000 through out the year of 2007. Moreover, a consortium including China Airlines and UPS won the Taipei and Kaohsiung cargo terminals privatization bid. This is our commitment to develop Taipei International Airport as a logistics center for global air cargo service.

Last but- not the least, based on the competence of our network and marketing position, to establish the complementary alliance partnership in terms of network coverage is essential for China Airlines to achieve its global strategic position. We are currently evaluating every opportunity to expand the cooperation with other groups based on the mutual benefits.

#### 4. CONCLUSION

As the liberalization and globalization are ongoing and inevitable, it will be times of greater challenges, more opportunities and, of course, more uncertainty regarding the aviation industry. Asian carriers should be well prepared to cope with the competitive international aviation environment Taiwan and China Airlines welcome the trend and are well-prepared for the competition on fair basis by concentrating on safety, services and commercial superiority.

As we stand on the threshold of the 21st century and looking ahead, one thing is certain: aviation will grow beyond our best-informed projections. How shall we prepare for the future and cope with the open international aviation environment?

The task of the government is to nurture the growth especially by providing compatible capacity expansion and to keep liberating aviation trade and investment under the WTO system by eliminating competitive obstacles. Most important of all, it has to make safety a single international standard at the highest possible level.

On the other hand, the task of the private sector is to innovate, to initiate, to invite the partnership of government, to lead, and to succeed. China Airlines will be determined and commit to the corporate strategy to overcome all the challenges ahead in the open international aviation environment and become the most reliable airline. -

Thank you.