Submission by N M T Geary on Qantas/Air New Zealand application dated 9 December 2003

As a former Chief Executive of Air New Zealand (1982-1989) and an individual who was deeply involved in the tourism industry between 1982 and 1997 (principally through my roles as CEO of Air New Zealand, Executive Chairman of the Mount Cook Group and the Chairman of the New Zealand Tourism Board) I am of the clear view that the arrangements as proposed are unnecessary and against the long term interests of Air New Zealand, the tourism industry, the travelling public and the national interest.

It is suggested that the only viable option open to Air New Zealand (ANZ) is to enter into the proposed strategic alliance with Qantas (QF) to secure its position as an international airline.

ANZ has in the past been a very successful airline. In my view it can once again be successful without entering into what is an unacceptable series of transactions with QF that will seriously compromise the future of the Company.

My principal concerns with the proposal are:-

1 Is the proposal necessary for ANZ to survive/thrive?

ANZ has in the past been a very successful airline and was well recognised internationally as such by the industry commentators. It has been one of the most profitable airlines in the industry in relative terms. Part of ANZ's success has been its focus on effectively promoting New Zealand and the Pacific. It has many fundamental strengths that properly harnessed can ensure success in the future. I reject the view that it must be part of a large regional or global carrier. Small and medium sized carriers that are well focused and managed have been, and are, successful. Large carriers such as United (now in Chapter 11) are not immune from bankruptcy.

Attached are the ten year statistics for ANZ immediately prior to privatisation in 1989 and the same statistics for the period ended June 2001. The first ten year figures show the recovery in 1983 from a massive loss, strong growth in passenger numbers internationally (1984 - 1989) and domestically (1984 - 1987 prior to the arrival of Ansett New Zealand) and very strong profits (with the exception of 1988 and 1989 which were influenced by greatly increased competition as deregulation took effect). During the early part of this period the airline industry was in considerable difficulty with massive losses occurring

and airline failures (eg PanAm, Eastern Airlines, Western Airlines). Notwithstanding this environment ANZ was a notable success. I should also note that in March 1982 the total share capital and reserves of the Company were $34.6 million. Total assets employed were $529.7 million and the revenue was $659.5 million. ANZ has in the past had to confront the challenges it does today. It has overcome them. ANZ has in the past had to confront the challenges it does today. It overcame them.
Also attached is a paper outlining some of the reasons why ANZ can be successful without the objectionable arrangements proposed.

2 There is fundamental conflict of interests in the proposal
It is envisaged that both airlines will continue to operate alongside one another to a number of international markets. Given that QF will obtain 100% of the commercial benefits from operating flights on their own right as opposed to 22.5% of the benefits if ANZ operates the services, QF will have a significant incentive to promote their own services in preference to those operated by ANZ. This is a fundamental conflict that is very likely to destroy shareholder value for ANZ and puts stresses on the QF/ANZ relationship, which must be regarded as somewhat fragile. Issues such as how will the New Zealand domestic and Tasman revenues and profits are shared arise.

3 The proposal is anticompetitive
Both airlines will be making very large profits from their respective domestic markets at present. Domestic airfares have risen dramatically in real terms in New Zealand in recent years. The proposal will create effective monopolies in the New Zealand market and trans Tasman. Service and fare levels will be vulnerable to exploitation. Where is the competitive brake? Furthermore no carrier is likely to enter the New Zealand domestic market against ANZ/QF who have significant market power.

4 Will the proposal benefit the tourism industry?
The Government, through Tourism New Zealand and ANZ, are the only serious promoters of tourism to New Zealand. Given that QF will have a significant say in ANZ international services beyond the Tasman there is a real prospect that QF will influence adversely the number of ANZ services on these routes, as already noted. This would seriously impact tourism flows. Additionally I have strong doubts that QF, and the Australian Government agencies will effectively promote New Zealand as a destination. As Chairman of the NZ Tourism Board I was keen for the NZ Tourism Board to join forces with our counterpart in Australia to jointly promote both destinations. Many visitors to New Zealand also visit Australia, accordingly this should be a focus of marketing. We were unsuccessful as the Australian Tourism Commission and their political decision takers were reluctant to put funds into promoting foreign destinations.

5 Is the proposal fair to ANZ?
The deal is lopsided in favour of QF.

a) They will be able to convert their loss making operations in New Zealand into significant profits by participating in a virtual monopoly in our domestic market.
b) Their proposed 22.5% shareholding will confer on them a quite abnormal level of influence over ANZ through the route coordinating committees and their Board of Directors representation. This is well out of proportion with their equity interest. If history is a guide to future conduct the previous QF involvement as a shareholder with Boardroom representation is likely to lead to significant instability and frustrations I observe here that Jim Scott, a past CEO of ANZ, who had direct experience of this former arrangement, recently publicly stated that QF "dorked" ANZ. Given the much deeper involvement now proposed through the coordinating committees and the ongoing fundamental conflicts of interest it seems clear that QF will have and even greater influence over ANZ to our national carriers detriment. They will have a significant incentive to promote their own interests as opposed to those of ANZ.

6 Industrial relations implications

Australian companies, including QF often experience more industrial unrest than New Zealand companies. Will this migrate across the Tasman? Will the New Zealand Unions seek to ratchet up the ANZ staff terms and conditions to those of QF? Will we see a return to the industrial relations problems ANZ encountered in the mid 1980's that led to the New Zealand Government understandably deregulating the airline industry in New Zealand to reduce the power of certain unions? There is a real potential for industrial difficulties! The unions will have an increased ability to pressurise the jointly managed airlines where the carriers will provide most of the capacity in this part of the world.

7 Will another airline such as Virgin Blue enter the New Zealand Market?

Despite the assurances that ANZ /QF are making regarding cooperating with a market entrant, it is highly unlikely that a new main trunk carrier will emerge to compete with the ANZ/QF monopoly.

Two main trunk carriers have not been viable in the past. How can three succeed? Given that ANZ/QF will operate significant international services in their respective rights and in concert any new carrier would be competively disadvantaged as QF/ANZ use their international services leverage and size against any new operator.

8 Will QF abandon the New Zealand domestic market if the proposal is not approved?

In the past Ansett Australia threatened withdraw from the New Zealand market. It is moot whether QF would adopt a similar approach. QF is operating a more cost effective fleet and is a more formidable carrier than Ansett was in New Zealand (and is therefore more likely to achieve profits in NZ) and given the attractiveness of inbound and outbound tourism to them, they would be unlikely to abandon the market. QF domestic services in New Zealand enhance their ability to service inbound and outbound markets and domestic air travellers.

9 Monopolistic behaviour

There have in recent months been discernible changes to ANZ's offering to the public in terms of their in flight services, schedules, the number of seats in aircraft, charges for excess baggage, queue lengths at airports etc. Given the increased market power of ANZ/QF under the proposed strategic alliance there is at least the real possibility that service levels and consumer benefits will be further reduced to boost profits. Airfares are likely to rise and seat availability tightened to increase load factors.

10 Will it be possible to unwind the strategic alliance?

The Minister of Finance has quite reasonably requested that ANZ should ensure that the proposal could be unwound for whatever reason if necessary. This will present ANZ and QF with a real challenge. If they are to achieve significant cost savings, and other efficiency benefits from their coordinated operations, structural changes will need to be considered, including IT systems and the duplication of support services. It would be difficult or very costly to unwind such changes. Attached is an article from "The Australian" dated 6 February 2003 that is relevant.

11 Related Party issues

Any strategic alliance initiative to confer benefits on either or both carriers raises related party issues. Both have a vested interest in the outcomes. How are these benefits to be shared and how are shareholder interests to be protected?

Conclusion

As can be seen from the foregoing there are many fundamental problems with the proposal.

It is up to QF and ANZ to address the issues that many are concerned with and develop a more acceptable solution.

From my point of view ANZ has been and can once again be a successful international airline without entering into the proposed arrangements.

- In any future proposal QF should not be represented on the Board of ANZ.

- QF shareholding should be restricted accordingly.

- The proposed monopolistic arrangements for the domestic market and the Tasman should not be approved - they are anticompetitive and whilst of benefit for the shareholders of both carriers at least in the short term, they are against the interests of the travelling public and the tourism industry. I believe that the arrangements could lead to the long term detriment of ANZ and its shareholding with the proposed QF influence in the alliance.

- ANZ/QF should be encouraged to cooperate in terms of the capacity each mounts on the Tasman to ensure that the market is well serviced and that both carriers on the route have good prospects of achieving reasonable financial outcomes. This would be vastly preferable

- ANZ/QF should freely compete in all other routes.

  Whilst any alternative solution will provide more challenges for ANZ, I believe the carrier is well capable of succeeding. It could be said that the present proposals help ANZ at an unacceptable cost to the consumer, the tourism industry and the national interest.

In this submission I have quoted the QF equity interest at 22.5%. My understanding is that they are only committed to 15%. Their influence or control is accordingly excessive for such a small shareholding.

TEN YEAR STATISTICAL REVIEW

Excludes Subsidiaries (Year To 31 March)		1989	1988	1987	1986	1985	1984	1983	1982	1981	1980
Trading ($000)	Revenue	1,582,207	1,417,742	1,415,110	1,280,151	1,148,161	891,552	775,786	652,526	551,644	453,603
	Expenditure	1,506,728	1,351,132	1,306,432	1,174,464	995,587	812,682	808,516	742,439	595,080	469,541
	Operating Profit (Loss)	75,479	66,610	108,678	105,687	152,574	78,870	(32,730)	(89,913)	(43,436)	(15,938)
	Non Operating Gains (Losses) inc. Taxation	(9,318)	(2,917)	67,660	78,580	(18,238)	23,570	66,233	40,572	12,849	28,353
	Profit (Loss) After Taxation	66,161	63,693	176,338	184,267	134,336	102,440	33,503	(49,341)	(30,587)	12,415
Passengers	Domestic	2,914,688	2,962,051	2,998,112	2,772,023	2,602,793	2,262,218	2,029,920	2,118,768	2,241,365	2,403,674
	International	1,689,997	1,518,866	1,413,384	1,211,743	1,100,009	997,243	944,905	991,766	1,047,402	1,006,225
	Total	4,604,685	4,480,917	4,411,496	3,983,766	3,702,802	3,259,461	2,974,825	3,110,534	3,288,767	3,409,899
Revenue Passenger Kilometres (million)	Domestic	1,502	1,506	1,494	1,382	1,304	1,130	1,013	1,048	1,086	1,161
	International	9,059	8,237	7,515	6,568	6,092	5,518	5,043	4,506	4,531	4,430
	Total	10,561	9,743	9,009	7,950	7,396	6,648	6,056	5,554	5,617	5,591
Available Seat Kilometres (million)	Domestic	2,256	2,189	2,132	1,992	1,838	1,644	1,527	1,555	1,604	1,649
	International	13,056	11,722	11,058	9,268	8,770	8,472	8,105	7,387	6,625	6,264
	Total	15,312	13,911	13,190	11,260	10,608	10,116	9,632	8,942	8,229	7,913
Passenger Load Factor (%)	Domestic	66.5	68.8	70.1	69.4	71.0	68.7	66.3	67.4	67.7	70.6
	International	69.4	70.3	68.0	70.9	69.5	65.1	62.2	61.0	68.4	70.7
Cargo and Mail Tonne Kilometres (million)	Domestic	24	24	26	26	26	24	24	26	27	31
	International	306	319	328	303	286	265	217	185	168	152
	Total	330	343	354	329	312	289	241	211	195	183
Revenue Tonne Kilometres (million)	Domestic	157	157	158	147	141	124	114	120	124	134
	International	1,168	1,102	1,042	927	865	788	696	613	598	573
	Total	1,325	1,259	1,200	1,074	1,006	912	810	733	722	707
Available Tonne Kilometres (million)	Domestic	262	257	251	233	212	190	180	186	187	200
	International*	1,707	1,551	1,470	1,242	1,171	1,147	1,096	984	880	809
	Total	1,969	1,808	1,721	1,475	1,383	1,337	1,276	1,170	1,067	1,009
Overall Revenue Load Factor (%)	Domestic	59.8	61.1	63.0	63.2	66.4	65.1	63.3	64.6	66.5	67.0
	International	68.4	71.0	70.9	74.6	73.8	68.7	63.5	62.3	68.0	70.8
Aircraft Fleet	Boeing 747-200	5	5	5	5	5	5	5	3	--	--
	Boeing 767-200	5	3	3	2	--	--	--	--	--	--
	Boeing 737-200	11	10	10	13	10	10	10	9	10	9
	Fokker F27	15	15	15	15	15	15	15	15	16	16
	Douglas DC-8	1	1	1	1	1	1	1	3	3	3
	McDonnell Douglas DC-10	--	--	--	1	2	2	2	6	7	7
Staff Numbers		8,621	8,046	7,768	7,484	7,020	6,864	6,980	8,172	8,798	8,981

*Excludes Charters & Lease Arrangements

As at 30 June:	2001	1999	1998	1997	1996	1995	1994	1993	1992
	7,960	3,359	3,089	2,931	3,000	2,888	2,598	2,338	2,209
xpenditure	8,014	3,209	2,959	2,759	2,746	2,602	2,399	2,198	2,075
urplus	(1,557)	150	130	172	254	286	199	140	134
tes / Associates	(165)	64	15	(22)	(29)	(26)	(8)	0	(19)
butable to Shareholders of Parent Company	(1,425)	314	145	150	225	260	191	140	115
r Share (cents)	(207.1)	37.8	25.6	29.0	50.8	58.7	43.3	32.7	28.9
r Share (cents)	4.0	15.0	16.0	20.0	20.0	20.0	14.0	10.0	10.0
	8,114	4,391	4,101	3,356	3,135	3,107	2,861	2,766	2,409
s' Funds	518	2,124	1,989	1,673	1,400	1,274	2,430	1,114	985
land – Domestic	4,251	3,536	3,491	3,512	3,558	3,626	3,381	3,117	2,999
land – International	3,578	2,986	2,908	3,122	3,033	2,756	2,430	2,090	1,915
nestic	12,394								
rnational	673								
	20,897	6,522	6,399	6,634	6,591	6,382	5,811	5,207	4,914
land – Domestic	2,033	1,634	1,598	1,610	1,655	1,637	1,507	1,421	1,365
land – International	20,172	18,031	18,011	18,671	18,458	16,086	14,090	12,360	11,633
nestic	13,825								
rnational	3,768								
	22,205	19,665	19,609	20,281	20,113	17,723	15,597	13,781	12,998
land – Domestic	2,994	2,717	2,697	2,664	2,706	2,648	2,464	2,396	2,403
land – International	28,332	26,229	26,298	26,960	26,987	23,158	19,579	17,808	16,096
nestic	18,691								
rnational	5,323								
	50,017	28,946	28,995	29,624	29,693	25,806	22,043	20,204	18,499
land – Domestic	67.9%	60.1%	59.2%	60.4%	61.2%	61.8%	61.2%	59.3%	56.8%
land – International	71.2%	68.7%	68.5%	69.3%	68.4%	69.5%	72.0%	69.4%	72.3%
nestic	74.0%								
rnational	70.8%								
	71.9%	67.9%	67.6%	68.5%	67.7%	68.7%	70.8%	68.2%	70.3%
land	755	833	851	796	692	581	493	428	428
nestic	145								
rnational	139								
	1,040	833	851	796	692	581	493	428	428
400	10	7	5	5	5	5	3	3	2
200	–	–	4	5	4	4	4	5	3
300	12	9	8	8	7	6	3	2	2
200	12	4	3	2	5	5	7	7	6
300	40	4	2	–	–	–	–	–	–
200	4	11	11	11	11	13	12	12	12
	20	–	–	–	–	–	–	–	–
0	7	–	–	–	–	–	–	–	–
0	7	–	–	–	–	–	–	–	–
CRJ-200	11	–	–	–	–	–	–	–	–
	24,479	9,177	9,560	9,340	9,929	9,618	9,039	8,791	8,825

CAN ANZ BE A SUCCESS WITHOUT THE QF DEAL?

I believe ANZ can succeed without surrendering its independence to QF or any other airline. The Star Alliance and One World arrangements that have been developed in recent years have been designed to build profitability without compromising independence.

1 Air New Zealand has an excellent reputation for quality service and engineering.

2 ANZ is highly reliant on the tourism industry and has specialised in promoting tourism, which is a large /high growth industry worldwide.

3 ANZ has a network of destinations that are very popular and will remain so.(Pacific Islands, New Zealand, Australia).

4 ANZ has the air rights and can mount capacity/frequencies in the Pacific Rim countries to tap the potential large tourism markets direct or through its Star Alliance partners.

5 ANZ has been a proactive marketer of its highly attractive network in the mass tourism markets and has achieved high growth.

6 ANZ has an employee cost structure and flexible work practises that are superior to QF.

7 ANZ has sufficient buying clout for aircraft and fuel purchases to be cost competitive.

8 Whilst QF in-flight service standards are high, ANZ is superior, which is a competitive advantage.

9 ANZ has leveraged its superior network and attractive destinations to build its traffic flows (revenues).

10 ANZ has been in a similar predicament in the past and has recovered and succeeded.

11 In the early 1980s the airline industry position was typified by:

- significant over capacity
- excessive competition and very low air fares on international routes
- difficult economic conditions internationally
- airline bankruptcies
- significant cost pressures

12 ANZ had other problems which exacerbated point 11

- post Erebus fallout
- ineffective/incomplete merger of Air NZ and NAC

13 ANZ Capital and Reserves as at 31 March 1982 totalled $34.6milliom. Total assets employed were $529.8 million. Operating loss for the previous 12 months was $89.6 million.

14 ANZ adopted strategies to boost passenger numbers and revenues with more aggressive marketing of the destinations it served.

15 ANZ cut costs significantly in all areas except marketing and increased its fleet utilisation on the basis of more effective marketing. This has been a powerful driver of profits.

16 Attached are the ten year statistics as set out in the 1989 and 2001 reports.

17 The 1989 statistics show that the airline grew its revenues and customer numbers significantly and it became a highly profitable airline, notwithstanding the state of the industry and the open skies environment it operated in.

18 There was much discussion in the aviation industry in the late 1980s about the development of massive airlines globally and regionally and the serious impact they would have on small/medium sized carriers.

19 ANZ concluded that very large carriers would be most unlikely to develop for a number of reasons, including the major difficulty there would be in managing them and the risks they would pose to funders due to the levels of financial exposure likely.

20 ANZ believed the future lay in strategic alliances.

21 The development of Star Alliance has been an excellent means of cooperation between airlines to mutual advantage. This is a crucial area for success.

NOTE The inherent strengths and market position of ANZ should not be under-estimated. Properly directed and managed it has in the past and can again be a very profitable and successful airline without prejudicing its independence or future with a major shareholding and Board involvement from a major competitor.

The Australian 6-2-03

Qantas-Air NZ deal will cost jobs, say unions

Steve Creedy
• Aviation

THE proposed $500 million alliance between Qantas and Air New Zealand would result in hundreds of job losses and a reduction in Australia's aviation skills base, the ACTU has warned.

The peak union body argued in its submission to the Australian Competition and Consumer Commission yesterday that the airlines had been disingenuous in claiming their alliance would not affect jobs.

It asked the commission to impose enforceable undertakings on the airlines that staff wouldn't be made redundant or disadvantaged by plans to co-ordinate scheduling, routes, capacity and aircraft.

"A growing Qantas should be in a position to provide undertakings that it will create more jobs in Australia," the ACTU submission said.

The proposed alliance, under which Qantas would pay about $500 million for a 22.5 per cent stake in Air NZ, is being scrutinised by competition watchdogs on both sides of the Tasman.

The ACTU submission rejected many of the arguments put forward by the airlines, and argued the proposal wasn't of public benefit or in the national interest.

It said the level of synergies proposed by the airlines to save costs could result in "hundreds of job losses within Australia and New Zealand".

"Such losses are not in the public interest or the long-term viability of the industry," the submission said.

"Following modelling undertaken after the collapse of the Air New Zealand-owned Ansett group of companies, it is estimated that for every direct Ansett job lost, another 2.5 external jobs were lost.

"We have no reason to believe that a similar multiplier would not apply should there be job losses within Australia and New Zealand."

The ACTU rejected airline assertions that cost-saving moves to co-ordinate operations would not result in less choice of carriers and frequency of flights.

It said the existence of full-service national flag carriers on both sides of the Tasman was vital to the future of industry and economic interests in both nations.

It also questioned Air NZ's ability to manage the airlines' joint operations, and said there was little evidence to support claims the tourism and export industries would benefit from the alliance.

However, the submission recognised the benefits of the hefty capital injection the deal would provide Air NZ.

A separate submission by the Australian Manufacturing Workers Union said a skills shortage in maintenance and engineering meant it was in the public interest to ensure Qantas retained its local maintenance operations.