

Cases in Strategic-Systems Auditing

Qantas Airways Limited



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Case Time Period—Late 1990s

The case is set in the late 1990s. Unless your instructor indicates otherwise, analyses and responses to discussion questions for this case should be based on the facts presented in this document and pertain to the time period presented.

Introduction

Qantas, the world's second oldest airline, was established in 1920 and takes its name from the original registered title, Queensland and Northern Territory Aerial Services Limited. In 1947, the Australian government purchased all of its shares making Qantas a public company. Then in 1992, Qantas purchased Australian Airlines, one of two domestic carriers, and the government decided to return Qantas to private-company status. This action allowed British Airways to purchase 25 per cent of the airline in 1993 (an ownership holding it has continued to maintain) and the privatisation was completed on 31 July 1995 when Qantas was listed on the Australian Stock Exchange.

Currently, Qantas is Australia's leading domestic airline, operating an average of 565 flights a day to 50 destinations in all Australian states and mainland territories. Having pioneered services from Australia to North America and Europe, it also is recognised as one of the world's leading international airlines with approximately 370 international flights weekly to 54 destinations in 32 countries. As can be seen in Table 1, the airline serves 25 major cities in the Asia/Pacific region (including six through code-share arrangements)¹; 13 in Europe (nine through code-share arrangements); 11 in North America (nine through code-share arrangements); two in South America (one through a code-share arrangement); two in southern Africa; and one in the Middle East (through a code-share arrangement).²

Region	Major Cities Served	Served Through Code Share
Asia/Pacific	25	6
Europe	13	9
North America	11	9
South America	2	1
Africa (southern)	2	0
Middle East	1	1

In recent years, the airline industry has been experiencing a form of consolidation through the creation of global alliances. These alliances have a significant strategic impact, allowing airlines to increase their route networks and access a larger customer base while utilising operating efficiencies.³ In September 1998, Qantas formed the **oneworld**TM alliance with British Airways, American Airlines, Canadian Airlines, and Cathay Pacific. By May 1999, Finnair, Iberia, and LanChile also had joined the alliance. In May 1999, the second major Australian airline, Ansett Australia, joined Air Canada, Air New Zealand, Lufthansa, Thai Airways International, United Airlines, and Varig as part of a global alliance known as the "Star Alliance," which had been formed earlier by Air New Zealand, Lufthansa, Thai Airways International, United Airlines, and Varig.

Expected benefits from these alliances include expanded route networks and streamlined processes, thereby, improving customer service and increasing passenger volume. For example, one of the advantages for Qantas of the **oneworld** alliance is its ability to provide one-stop flights to a host of European cities serviced by alliance member Cathay Pacific—a former archrival. Qantas and Cathay Pacific are expected to benefit from the increased synergies and added services in the region.⁴ Other

¹ Code sharing generally refers to the situation where an airline offers seats on a particular route without necessarily operating on it. Usually this is done by purchasing a block of seats from another airline. In Qantas's case, code share refers to flights on other airlines that carry a QF (Qantas) flight number.

² Qantas Airways Limited Web site, www.qantas.com.au accessed August, 1999.

³ Global alliances can be seen as a logical evolution from code-share arrangements, which focused primarily on operating arrangements. Global alliances have a broader strategic focus, going beyond cost savings associated with code sharing to focus on strategic advantages such as integrated services, common customer bases, and joint purchasing and marketing.

⁴ *Aviation Week & Space Technology* (September 28, 1998) p.57.

potential benefits of the **oneworld** alliance include the ability to achieve economies of scope and scale resulting from multi-carrier frequent-flyer loyalty programs, and, in the future, joint purchasing of fuel, parts, planes, and advertising.

However, participating in the **oneworld** alliance presents new business risks to Qantas. James Strong, then the chief executive and managing director of Qantas, claimed that at the time it entered into the alliance, Qantas's two main assets were its brand and its customer base.⁵ Participation in the global alliance could either increase or decrease the value of these assets.

The Qantas brand has a proud history with a focus on customer service and engineering excellence. In 1996, *Air Transport World*, a trade publication, named Qantas "Airline of the Year." The following year, for the eighth consecutive time, the airline was named the Australian company with the best corporate image by the *National Business Bulletin*, an Australian business management magazine. Additionally, Qantas has a reputation for being one of the world's safest airlines—in fact the airline's safety record was touted in the 1988 film, *Rain Man*, when Dustin Hoffman's character points out that Qantas is the only international airline that has never crashed.

Although all global alliance members share the **oneworld** name and logo, they are intended to supplement—not replace—each airline's own corporate identity, appearing alongside their logos on airports, aircraft, and timetables. At a meeting of the chief executives of **oneworld** in 1999, there were differing opinions over how globalisation would affect the choice of travellers and fares and whether national brands would eventually become subordinated to **oneworld**. Strong believes that global brands eventually will dominate, but there always will be a place for the Qantas name. "There is going to be an overarching brand. But I don't foresee at this stage the area brand disappearing. In our case, that would be throwing away a huge asset which is so important to Australians."⁶

The **oneworld** alliance creates significant changes for Qantas customers; for example, a Qantas customer purchasing an around-the-world ticket might fly with any of the **oneworld** alliance member airlines. If the quality of the flight experience (which may include the aircraft, checking-in procedures, airline personnel, catering, delay, and baggage handling) were below expectation, customer satisfaction may be adversely impacted. Thus, Qantas customer satisfaction may be significantly influenced by other airlines, whereas before the **oneworld** alliance, airline passengers generally would judge their experiences on an airline-by-airline basis. Now these experiences will be combined and compared with customer experiences on other international alliances. With these types of risks in mind, **oneworld** alliance partners carry out customer surveys to uncover any changes in customer satisfaction over time.

In summary, the benefits for Qantas of being a member of a global alliance are tempered by reducing direct control over two of its most important assets—brand name and customer base. In fact, the structure, membership, and formation of an alliance are critical issues to each of the separate airlines as is the financial performance of each member airline critical to an alliance's viability.

Airline Industry Overview

External Forces

The airline industry is regulated heavily. Along with the considerable number of safety regulations, there are air service arrangements (ASAs) between countries. These agreements control capacity for take-off and landing slots and become barriers to entry for international routes. In a move toward

⁵ Sandilands, B., "When **oneworld** and Star collide." *Business Review Weekly* (March 8, 1999) pp. 20-38.

⁶ Gottlieb, R. and L. Schmidt. "Fight for the skies," *Business Review Weekly* (October 12, 1998) pp. 76-80.

making bilateral arrangements more liberal, the Australian government's Productivity Commission endorsed a proposition on 1 June 1999 that would have given international airlines virtually unlimited access to some of Australia's most frequented tourist destinations subjecting airports in Coolangatta, Cairns, Adelaide, and Darwin to increased traffic. However, the government did not adopt the full "open skies" policy suggested by the commission. Instead, the government accepted submissions by Qantas and Ansett that foreign airlines should not be allowed to compete with domestic airlines for passengers and cargo inside Australia. The Government also retained access limits in Sydney, Melbourne, Brisbane, and Perth, which are the four biggest airports in the country.⁷

The structure of the international airline industry is important in several respects. For example, there are a limited number of aircraft suppliers and there are peaks and valleys in the demand for new aircraft. The two major suppliers of commercial aircraft in the world are Boeing (United States)—the largest—and Airbus Industrie, a partnership of Aerospatiale, Germany's DaimlerChrysler Aerospace Airbus, British Aerospace, and CASA of Spain—Europe's largest aircraft manufacturers. Analysts believe that current indicators such as traffic growth, load factors, and yields suggest that the airline industry reached a cyclical peak in 1998/99.

In an effort to increase supply-chain efficiencies, Boeing and British Airways are developing a Global Airline Inventory Network.SM This network is an innovative service in which Boeing will manage British Airways's supply chain for expendable airframe spare parts used in its fleet of Boeing aeroplanes. Included therein are parts from Boeing as well as other suppliers. This network is designed to reduce costly inventory inefficiencies, such as duplication of distribution levels and unnecessary inventory levels. Boeing will begin offering this service to additional airlines once it has been successfully implemented at British Airways.⁸

As a result of the ongoing restructuring of the industry through mergers, bankruptcies, and federal budget cuts in the United States that resulted in pilots leaving the military, an oversupply of pilots is expected by 2006. Airline industry deregulation and increased competition has stimulated airlines to cut costs and in some cases, pilots' salaries. Consequently, in 1998 there were several labour actions including pilots at British Airways, Air France, All Nippon Airways, Cyrus Airways, and Philippine Airlines. There also were several high-profile work slow-downs. A slow-down at American Airlines culminated in the Allied Pilots Association (APA)—a non-AFL-CIO union representing the American Airlines pilots—receiving a huge fine from the U.S. courts. Flight attendants and ground crews also have walked out in Mexico, Spain, South Africa, and other countries. The majority of disputes relate to airline companies' attempts to suppress wages, increase productivity, and out-source jobs to lower-cost subsidiaries. For example, in June 1998 Air France pilots were told that they had to compete with Lufthansa pilots who had accepted a 24 per cent pay cut and to increase their cockpit hours to create parity with British Airways's pilots.

In response to the growing global alliances among airlines, pilots and unions have established various forms of international co-operation. In August 1998, for example, unions representing 24,000 internationally based pilots formed the Alliance Coalition. This organisation shares industry information and helps raise wage levels so that airlines do not have incentives to shift flights to lower-wage crews.⁹ In Australia, although tensions due to wage restraints exist, there have not been any pilot strikes since 1996.

⁷ Wainwright, R. "More airports to turn international," *The Sydney Morning Herald* (June 1, 1999).

⁸ The Boeing Company Web site, www.boeing.com/news/releases/1999/news_release_990922b.html accessed March 3, 2000.

⁹ World Socialist Web site, www.wsws.org/workers/1998/sep1998/air-s04.shtml.

Key Performance Indicators for International Airlines

There are many profitability measures for the airline industry. Passenger air transportation revenue, similar to most service revenue, is a function of price and volume. Key measures include passenger traffic (i.e., revenue passenger kilometres/miles or RPK/RPM)¹⁰, capacity (i.e., available seat kilometres/miles or ASK/ASM),¹¹ and passenger load factor (i.e., ratio of RPK to ASK). Other measures are yield per RPK/RPM (i.e., average fare paid per occupied seat kilometres/miles flown), and passenger revenue per ASK/ASM (i.e., revenue generated per unit of capacity). If an airline were able to increase the number of revenue passengers travelling on a particular flight (i.e. load factor) or increase the average fare paid by each passenger on that flight (i.e. yield per RPK), passenger revenue per ASK would increase, which in turn would lead to greater profitability on that flight. The higher the revenue per ASK, the more revenue generated by the airline per unit of capacity offered. Passenger revenue per ASK is considered to be one of the best measures of passenger revenue performance.¹²

Some key performance indicators (KPIs) for the airline industry are summarised in Table 2 below:

Table 2 Sample KPIs for International Airline Industry	
Traffic and Capacity KPI	Formula
1. Passengers Carried	1. # paying passengers carried
2. Revenue Passenger Kilometres (RPK)	2. # paying passengers carried x # kilometres flown
3. Available Seat Kilometres (ASK)	3. Total # seats available for passengers x # kilometres flown
4. Revenue Seat Factor (RSF)	4. % of total passenger capacity actually utilised by paying passengers (RPK/ASK)
Productivity KPI	Formula
1. Number of Employees	1. # average full-time equivalent employees
2. RPK per Employee	2. $\frac{\text{\# paying passengers carried} \times \text{\# kilometres flown}}{\text{\# average full-time equivalent employees}}$
3. ASK per Employee	3. $\frac{\text{\# seats available for passengers} \times \text{\# kilometres flown}}{\text{\# average full-time equivalent employees}}$

¹⁰ RPK is calculated by multiplying the number of revenue passengers travelling on each flight stage by distance in kilometres between the ports. The distances used are 'Great Circle Distances,' the shortest distance between any two points on the globe as measured over the earth's surface.

¹¹ AKS is calculated by multiplying the number of seats available on each flight stage by the 'Great Circle Distance' in kilometres between the ports.

¹² Canadian Airlines Corporation Web site, www.cdnair.ca/, accessed November 6, 1999.

Economic History and World Trends

Global Growth

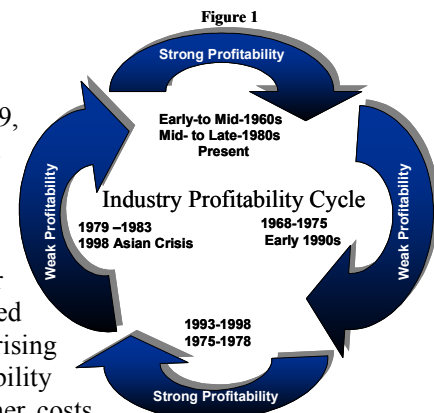
Until recently, air transport has been a high-growth industry. The rate of growth, however, has slowed as the industry became larger and more mature. Two key factors contributing to sustained growth in air transport have been economic development/prosperity and the declining real cost of air travel. It also must be recognised that while there has been an overall high growth rate in international air travel, there are substantial differences in growth from one part of the world to another. Until 1998, for example, Asian airlines had experienced growth rates well above the world average, whereas growth in Africa has been more modest.

The rapid growth of Asian airlines such as Cathay Pacific, Malaysia Airlines, and Singapore Airlines significantly impacted the structure of the industry,¹³ as did the Asian economic downturn in 1998. Many carriers, especially those heavily exposed to the region, were hit hard by falling currency values, reduced load factors, and reduced revenues. While Singapore Airlines, Cathay Pacific, Qantas, and Air New Zealand had enough cash reserves to weather the crisis, other airlines such as Philippines Airlines, Garuda, and Thai Airlines faced major cuts.¹⁴

The Asian economic crisis also played a role in a global shift of airline capacity. Aircraft that previously operated in the Asian Pacific region were deployed elsewhere around the world. For some airlines redeployment was easier to achieve than for others. According to some reports this crisis created a capacity problem. For example, 198 new aircraft were delivered to Asian carriers in 1997, 268 aircraft in 1998, and 186 were delivered in 1999. These new aircraft deliveries might have created significant over-capacity¹⁵ but there also is a belief that there have not been excessive commitments for new capacity. Further, there are many older, fully depreciated aircraft that may become retirement candidates should growth in the demand for air travel continue to slow down.¹⁶

Profitability

Despite traffic growth over the three-year period prior to 1999, profitability of the global airline industry has been cyclical but relatively poor on average.¹⁷ In many cases, airlines have performed so poorly that they are dependent on government subsidies. There was a period of relatively strong profitability in the early and mid-1960s when unit-cost reductions more than compensated for decreases in load factors, revenue yields, and fares. But that changed in the period from 1968 to 1975 when declining load factors and rising fuel prices could not be offset by cost reductions. Industry profitability increased between 1975 and 1978 when the price of fuel and other costs declined in real terms and demand was once again buoyant. Then in 1979 to 1983, there were large losses for the industry when demand became stagnant and some airlines went bankrupt. The second



¹³ Productivity Commission, *International Air Service Report No.2* (September 11, 1998); www.pc.gov.au/ accessed November 6, 1999.

¹⁴ Williams, M., "Crisis! What Crisis?" *Airfinance Journal* (February 1998) pp. 40-42.

¹⁵ Ott, J. "Widebodies Manoeuvred In Global Capacity Shift," *Aviation Week & Space Technology* (August 24, 1998) pp.32-36.

¹⁶ American Airlines, Inc. Web site <http://www.amrcorp.com/> accessed November 6, 1999.

¹⁷ Productivity Commission, *International Air Service Report No.2* (September 11, 1998); www.pc.gov.au/ accessed November 6, 1999.

half of the 1980s saw a turnaround in profitability, as economic growth increased and the real price of fuel fell (see Figure 1).

The economic recession of the early 1990s and the large numbers of aircraft accumulated by airlines also squeezed profitability. The effect was exacerbated by general concerns about the safety of aviation (for example, hijacking) arising from tensions in the Middle East, which culminated in the Gulf War in 1991. The industry has recovered since 1993 and, at least until the Asian crisis, was achieving much the same level of profitability as in the late 1980s.¹⁸

Today, the industry remains intensely competitive. However, each of the major carriers has a route system well adjusted to its individual strengths. As a result, the major carriers have — for the most part — focused their attention and resources on their major hubs and on other markets where they've historically done well.

Economic History and Industry Structure In Australia

Passenger movements on scheduled Regular Public Transport (or RPT) flights to and from Australian airports rose from 22.46 million in 1976/77 to 68.37 million in 1996/97, at an average annual growth rate of 5.7 per cent. International passenger traffic increased from 2.89 million passengers in 1976/77 to 13.76 million in 1996/97, an average annual growth of 8.1 per cent. Cargo (freight and mail) carriage to and from Australia rose at an even faster rate than passengers, from a total of 86,500 tonnes in 1976/77 to 639,100 tonnes in 1996/97, an annual average growth of 10.5 per cent. Domestic airline passenger carriage increased from 9.37 million to 23.46 million between 1976/77 and 1996/97. RPK rose from 7.35 billion in 1976/77 to 26.31 billion in 1996/97, an average annual growth rate of 6.6 per cent. During the same period the revenue passenger load factor increased from 67.1 per cent to 73.4 per cent.

The Australian airline industry has seen considerable internal changes over the last 10 years. Since 1989, the Commonwealth Government has made several significant changes to its air services policy that have influenced the structure, efficiency, and competitiveness of the Australian international and domestic air services markets including:

- domestic deregulation (i.e., abolition of the 'two airlines' policy and the privatisation of Australian Airlines, which occurred in 1990)
- relaxation of restrictions on equity investment in Australian airlines and privatisation of Australia's government-owned airlines
- agreement between Australia and New Zealand for a Single Aviation Market, allowing airlines from both countries to fly unrestricted between and within each country
- liberalisation of Australia's air freight and charter policy
- privatisation of most Australian airports (except airports in the Sydney region).

The merger of Qantas Airways and Australian Airlines in 1993 precipitated the surge in available domestic seat kilometres from 1993/94 when the Qantas international aircraft fleet became available for domestic services. Since the merger, there also has been a delegation of secondary routes to the regional airline sector, allowing the major domestic airlines (Qantas and Ansett) to create efficiencies by rationalising fleet equipment and concentrating on busier routes.

¹⁸ Productivity Commission, *International Air Services Report No.2* (September 11, 1998); www.pc.gov.au/ accessed November 6, 1999.

Airline Industry Alliances

According to *Business Review Weekly*, the recent trend of airlines forming alliances suggests that “these big airline groupings are about scale of market in sheer numbers, dominance of hub airports such as in Singapore, multi-carrier frequent-flyer loyalty programs, and, eventually, efficiencies of scale in purchasing everything from fuel, parts and planes to advertising.”¹⁹

Types of Alliances

The term alliance is used widely and can encompass bilateral agreements, joint frequent flyer programmes (FFP), joint fleet planning, code-share arrangements on specific routes, block-space agreements on specific routes/flights, and global alliance agreements.²⁰

During the mid 1990s, code-share agreements became a common form of alliance between airlines. Regulatory authorities generally have permitted airlines to engage in code sharing subject to the condition that they price and sell their capacity separately and not engage in revenue pooling. For example, in the United States, the Department of Transportation allowed Delta Airlines and Swissair to code share only on the basis of assurances that they maintain separate marketing, sales, pricing, and risk of profit or loss for each of the routes concerned. In Australia, the International Air Services Commission (IASC) has indicated that approvals of joint services arrangements normally include a condition that the Australian carrier must price and sell its service independently on the shared route/flight and that there be no sharing or pooling of revenue.²¹

The industry has recently seen the emergence of strategic global alliance groupings, such as the Star Alliance and oneworld. These global alliances can be distinguished from earlier alliance forms (such as code sharing) by their broader strategic focus such as integration of route networks and integrated marketing. The code sharing form of alliance (such as that between British Airways and Qantas) did not provide the worldwide route network that is possible with multi-airline alliances. Global alliances also bring benefits such as access to the very large customer databases of alliance members.

Following is an extract from a speech by Scott Yohe, senior vice president of Delta Airlines to a U.S. Senate Committee on the overall importance of these alliances²²:

What we are engaged in is nothing short of a major transformation of the industry. It is occurring in direct response to the demands of our customers. By forming these alliances we are responding to the needs of the marketplace. In turn, we are creating global networks that give hundreds of communities fast and efficient access to international commerce.....

In order to compete in the global race, we have had to change the way we do business and meet the demands of our customers for fast, convenient access to destinations throughout the U.S. and the world. Yet, responding to these changes in a traditional fashion was just too expensive. With the price of modern aircraft pushing \$150 million, carriers could not afford to devote resources to thin, untested international markets. The losses we experienced in the early 1990s—especially in the international arena—made carriers extremely adverse to risky international expansion. Yet, knowing we had to respond to these changes, we devised a different approach.

¹⁹ Sandilands, B. “Ansett’s ‘virtual’ global future,” *Business Review Weekly* (April 9, 1999) p. 65.

²⁰ KPMG, *Air Transport Business Model* (September 10, 1998). Block-space agreements occur when one airline sells a block of seats to another airline. It only becomes a code sharing arrangement where dual flight numbers are used (e.g, QF/AA).

²¹ Productivity Commission, *The Economic Impact of International Airline Alliances* (1998) p. 37; www.pc.gov.au accessed November 6, 1999.

²² Delta Airlines Web site, www.delta-air.com/docs/house_judi.doc accessed November 6, 1999.

The answer has been international alliances. Carriers have sought partners with strategically well-positioned international hubs. These hubs provide vast connecting complexes enabling passengers to conveniently connect flights to a number of destinations. Each partner then takes advantage of the other's route networks by building "bridges" between the hubs. These "bridges" take the form of long-haul, intercontinental flights. Ideally, the result is seamless cooperation that allows customers to gain access to a vast new network created by the partner.

Alliances result in more elaborate and complicated customer loyalty programs. As airlines add partners and offer partner routes in their programs, costs mount. At American Airlines, Ed French, managing director of marketing planning and consumer research, says, "While we're proud of [our loyalty program] and are constantly trying to innovate, it is also expensive. Included in the expense is the cost of rewards and large marketing costs." French adds that a key benefit to these programs is the resulting database that captures customer travel preferences facilitating target marketing.²³

Selected Core Business Processes at Qantas

Airlines sell two general categories of services—passenger travel and air freight. The airline industry is very competitive and slight differences in operations and quality of service can significantly impact an airline's reputation and brand image. Failures in any of a number of areas (e.g., flight operations, ground operations, human resources, technology) can create negative customer experiences, thereby, increasing the likelihood that the customer will fly with a competitor the next time the occasion to travel arises. For any airline to excel, numerous processes must be well designed and executed. Following is a discussion of selected core business processes at Qantas.

Sales and Marketing

Sales and marketing activities attract customers to the airline and create continuing revenue opportunities. As part of sales and marketing, Qantas strives to maximise brand awareness by developing and managing key marketing relationships. In the airline industry, customer satisfaction is thought to be critical to maximising revenue. A key determinant of customer satisfaction is the ability to service routes at specified times for a price that travellers are willing to pay. Determining that price for different types of customers is a major challenge for an airline.

Sales and Distribution

An important sub-process of sales and marketing is sales and distribution. Qantas strives to optimise sales revenue from different classes of tickets so that a route structure is used effectively while concurrently minimising costs for distribution and regulatory compliance. Sophisticated systems facilitate route forecasting, route profitability analysis, and flight and ticket scheduling (demand for particular classes of tickets per route over specific time periods). Qantas uses a complex computerized yield management system to ensure an optimal mix of fare levels on flights based on the huge range of fares being offered for thousands of flights per day. This system employs mathematical formulae to forecast demand by allowing for historical and seasonal factors such as peak demand periods for business and vacation destinations, economic swings affecting longer term travel demand, seasonal schedule changes, and changes in aircraft capacity.²⁴ Properly undertaken, such analysis aids in maximising revenue for individual flights.

²³ Feldman, J. M. "The premium payoff," *Air Transport World*, (March 1998) pp. 47-49.

²⁴ Qantas Airways Limited Web site, www.qantas.com.au/company/factfiles/yield.html.

Pricing and Yield Management

Pricing and yield management is a sub-process of sales and marketing that is aided by the practice of making airline tickets non-transferable, although this practice is more rigid (and more easily checked) for international flights than for domestic flights. Additionally, electronic ticketing (which requires personal identification) effectively makes domestic tickets non-transferable. Non-transferability helps Qantas create market segments and manage yields. Not only can it offer a substantial differentiation of services on one aircraft (by offering different classes of travel, conditions of advance purchase, cancellation, etc.), it also can charge different prices for similar seats on an aircraft. Qantas can tailor prices to classes of customers and, for price inelastic customers, set fares significantly above the marginal or average costs of supplying the service. Thus, business class fares are higher than economy class fares because they provide passengers with a higher standard of service. Also, business travellers often book (and alter reservations) at short notice and are willing to pay for this convenience.

Given enough knowledge about the preferences of different groups of travelers and the use of powerful computer reservations systems (CRSs), Qantas can vary ticket prices almost continuously—across classes of passengers and over time—as a means of increasing yields. Airline yield management systems and yield management systems within alliances operate in concert with consolidators²⁵ (or wholesalers) to provide consumers a wide choice of carriers, prices, routes, and schedules. Qantas maximises its capacity utilisation and consumers obtain access to the lowest fares given their needs and preferences.²⁶

At Qantas, the integrated reservations and departure control system for international and domestic services is known as QUBE (Qantas Universal Business Environment). At a cost of more than \$100 million and taking two and one-half years to complete, developing the system was one of the largest information technology (IT) projects in Australia. Complete transition to the new system occurred in early 1999. Transition to a single-yield system known as RATIO (Revenue Advantage Through Inventory Optimisation) occurred at the same time. One advantage of these systems is improved yield management resulting in bottom line financial benefits.²⁷

Customer Loyalty

Another element of sales and marketing for Qantas is its customer loyalty program. Qantas's frequent flyer program, which had about 1.7 million members in June 1999, comprises about one-third of its passengers. Revenue from the frequent flyer program and associated loyalty schemes is growing faster than revenue from any other part of the business. James Strong, managing director, says that Qantas has only reached the first phase in using its customer base and he says: "It is showing tremendous potential, and you will see things in the future that will take that much further than it is at the moment. It is a tremendous brand and it is a tremendous customer base."²⁸ Alliances also bring in revenue from frequent flyer programs by giving member airlines access to other alliance members' frequent flyers. For the **oneworld** alliance members these include members of the Advantage frequent flyer program of American Airlines—one of the biggest customer bases in the world. American launched its loyalty program in 1981. It was supposed to be temporary and aimed at 350,000 high-fare flyers. Now, American's program alone has more than 24 million members.

²⁵ There can be up to 30 different ticket categories on any flight including first class, business class, and economy, with different combinations of advance purchase, duration of travel and weekend stays.

²⁶ Productivity Commission, *International Air Services Report No.2* (September 11, 1998) p. 23; www.pc.gov.au accessed November 6, 1999.

²⁷ Qantas Airways Limited Web site, www.qantas.com.au/company/factfiles/qube.html

²⁸ Gottlieb, R. and L. Schmidt. "Fight for the skies," *Business Review Weekly* (October 12, 1998) pp. 76-80.

Qantas's major asset is its customer base, and one of its major objectives is maintaining and improving customer satisfaction. Customer satisfaction is critically dependent on the perceived level of service and the reliability and comfort of flights. However, passenger comfort and cost control often are in conflict because the capital cost associated with purchasing equipment and the costs associated with engineering and maintenance are substantial. Unless an aircraft is in the air for 13 or 14 hours a day, with a load factor of more than 70 per cent and a reasonable ticket price, it will operate at a loss.²⁹ Improved fleet management and planning impacts profitability. Qantas has to control these costs while ensuring that it does not damage its brand name and reputation.

Aircraft Operations

Aircraft operations is a core business process that involves aircraft pre-flight preparations. Within aircraft operations is the engineering and maintenance sub-process. This process is responsible for minimising aircraft downtime and ensuring safety, for which Qantas enjoys an excellent reputation. An additional sub-process, flight operations, is charged with assuring that all aircraft movements are staffed adequately, delays are minimised, and in-flight service is of an appropriate quality. Finally, the ground operations sub-process ensures timely departure, safety while on the ground, and that aircraft cleanliness meets Qantas's standards.

Business Development and Management

Business development and management deals with enhancing relationships with key external parties and building alliance networks that give Qantas a competitive advantage. The goal is to use enhanced alliance networks to increase the feed of alliance member passengers into the alliance partner networks and to attract new customers to the alliance through improved customer services and benefits. Establishing, maintaining, and managing alliances with other airlines and outside parties is an ongoing challenge for Qantas.

Passenger and Freight Movement

Passenger and freight movement ensures the quality of transportation services for passengers and optional use of capacity for freight delivery.

Other Core Business Processes

Resource Management Processes

In addition to the processes described previously, Qantas performs several activities related to day-to-day operations. Resource management in the area of finance encompasses treasury and accounting functions. Treasury is responsible for funding operations and aircraft acquisitions and managing cash flows. The aim is to optimise financing structures for capital acquisitions, ensure sufficient funds are available to meet operational objectives, and manage short-term and long-term liquidity, including the investment yield on surplus cash holdings. For international airlines, control of cash flows receivable or payable in foreign currencies also is important. The accounting function produces relevant and timely financial and management reports and monitors control systems. Recognition of revenue within the accounting process is particularly important given the complexity of ticket sales and usage. These activities are discussed in more detail later.

²⁹ Gottlieb, R. and L. Schmidt. "Fight for the skies," *Business Review Weekly* (October 12, 1998) p. 79.

IT continues to be a challenging area for resource management. IT provides appropriate data processing systems for accurate and relevant operational, financial, and compliance related information. In 1999, IBM conducted a survey of IT use in the airline industry and found that more than 90 per cent of airline executives place a high priority on their IT resource process.³⁰ According to the survey, the highest priority areas for IT investment include employee productivity, customer value management, business management and reporting, alliance integration, customer profiling, network and schedule development, revenue management, Internet bookings, crew management, and electronic ticketing.

Given the importance of a company's reputation, human resource management also is critical. Because most customers have direct contact with numerous Qantas employees, appropriate management of human resources is important for ensuring that a skilled and motivated work force is attracted and retained. The safety and risk management process also falls under human resources because of the skill sets unique to pilots and the necessity for trained personnel that can identify and respond to all airline risks. Finally, because much of a customer's experience with an airline occurs on the ground (ticketing, check-in, baggage handling), the airline must hire competent and congenial ground personnel.

Revenue Recognition

Revenue recognition is complex for airlines because revenue often is received before passenger tickets are used. Thus, some revenue is unearned and must be recognized as a liability. As stated in Qantas's 1998 financial report, "Passenger and freight sales are credited to revenue received in advance and subsequently transferred to revenue when tickets are utilised ..."

Figure 2 depicts the accounting for revenue process. The sales accounting department is responsible for making sure that the financial database is updated for sales/ticketing data. Travel agencies usually are prompt forwarding sales receipts to Qantas from which they receive a commission. Agents have specified pay dates and also specified dates by which the payment must be forwarded to Qantas. The matching of tickets sold to payment is a very tightly controlled process.

Upon receipt of payment, sales are entered into the "revenue received in advance (liability)" account. At any given time the balance in this account can be quite large—at 30 June 1998 it was more than \$800 million based on passenger revenue of \$6 billion. Revenue is deemed to be earned when the passenger flies, which is identified by matching the sold coupons with the used coupons. For passengers flying on Qantas's flights this process has few stages and is relatively easy to control.

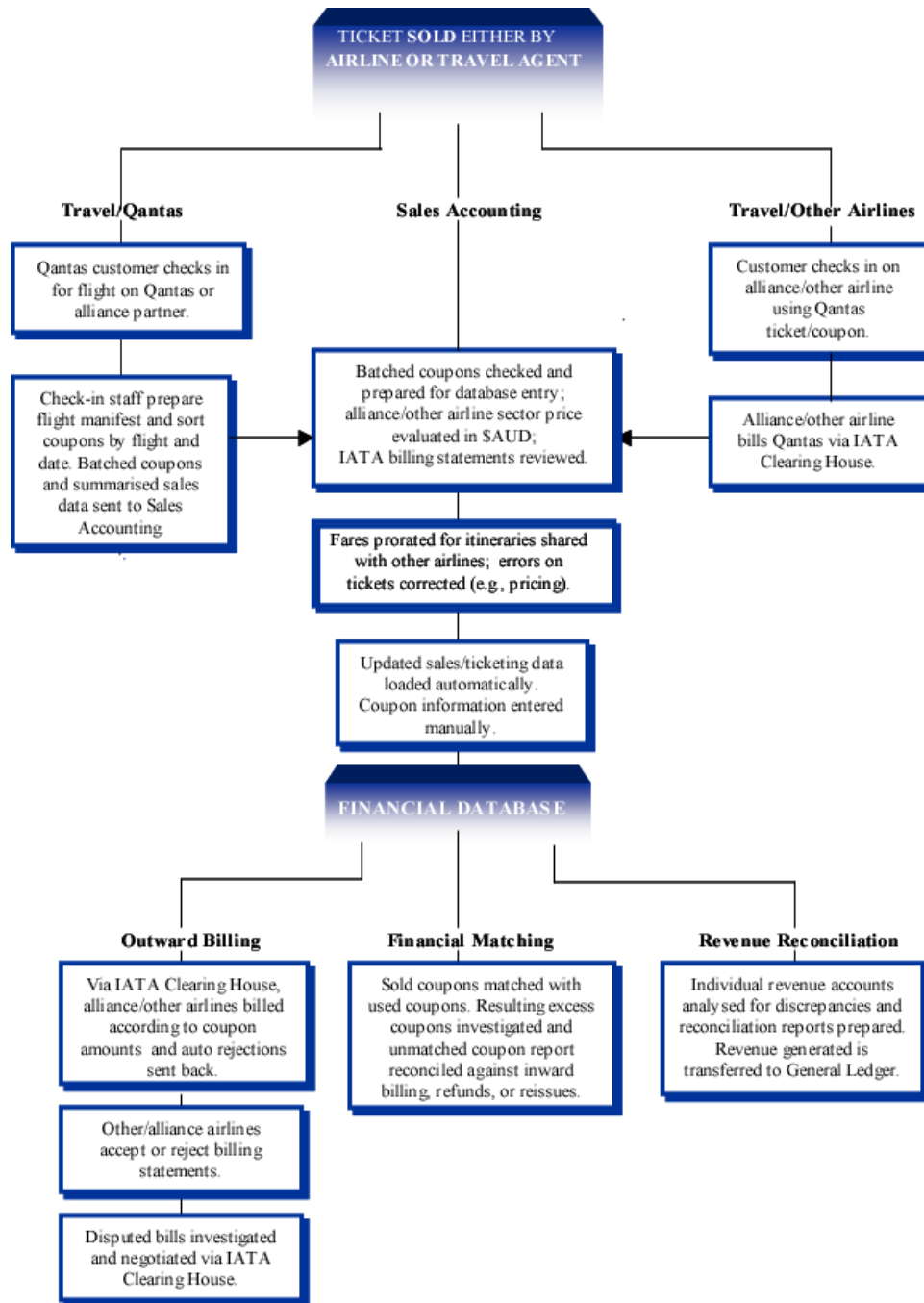
For passengers flying on other carriers, the process is more complex. For example, if a person buys an around-the-world ticket, their itinerary will include not only Qantas flights but flights on other **oneworld** carriers. Sharing revenue from around-the-world tickets is undertaken in accordance with standard pro-rate agreements determined by the International Air Transport Association (IATA), which also serves as a clearinghouse for processing airline coupons. Although airlines have an incentive to submit used coupons to IATA as soon as possible after the flight, this process has traditionally been slow. Airlines, therefore, have had to estimate the amount of air travel undertaken by passengers on other airlines, which is unbilled at the time of preparing financial reports.

At fiscal year-end, Qantas has to estimate the amount of revenue earned from its customers for flights on other airlines, apportion the total fare to those sectors travelled, and allocate from revenue received in advance to revenue earned that amount relating to services provided or allocate to trade creditors for that amount to be paid to other airlines in accordance with the IATA pro-rate

³⁰ IBM, *World Airlines Benchmark Report* (1999).

agreements. If Qantas provides the service for tickets on other airlines before the end of the financial year, it records a receivable and recognises revenue in accordance with the IATA prorate agreement.

Figure 2 - Revenue Accounting Process



Organizational Structure

Routes and Services

For the year-ended March 1999, Qantas carried 35.9 per cent of the international passengers that travelled to Australia. Percentages for other airlines are as follows:

Airline	Per cent (%)
Air New Zealand	9.6
Singapore	8.6
British Airways	4.8
Malaysia	4.8
JAL	4.2
United	4.1
Ansett	4.0
Cathay	3.7
Thai	2.8
Other	17.5

(Source: Department of Transport Web site, www.dot.gov.au, accessed 8 June 1999)

From April 1998 to March 1999 Qantas moved 5,196,104 passengers (compared with 5,332,362 in 1997/1998 and 5,272,897 in 1996/1997). The number of passengers transported across its major routes over this three-year period is shown in Table 4 below:

	1996-97	1997-98	1998-99
China	28,742	51,945	58,127
Fiji	106,503	104,343	122,498
Germany	106,889	118,411	114,262
Hong Kong	359,996	351,327	364,902
Indonesia	373,356	406,589	381,607
Italy	56,775	59,868	59,601
Japan	786,545	769,556	715,874
Korea	116,579	75,267	12,993
Malaysia	61,210	66,689	35,823
New Zealand	1,123,356	1,103,589	1,154,247
Papua New Guinea	75,961	77,541	73,608
Philippines	63,801	72,470	123,160
Singapore	607,524	635,883	559,406
South Africa	71,824	77,165	81,830
Taiwan	74,666	74,093	64,700
Thailand	203,023	189,386	159,419
UK	284,994	301,199	289,185
USA	591,207	601,471	597,886

(Source: Department of Transport Web site, www.dot.gov.au, accessed 8 June 1999)

Qantas draws 20 per cent of its RPK³¹ from the Asian region other than Japan. However, half of that business is low-yield, tourism-related traffic bound for Australia. In 1998, the airline abandoned its operations in South Korea and Vietnam after a 65 per cent plunge in demand and rationalised some

³¹ See footnote 10.

flights to Thailand and Indonesia. “We’ve made fairly rapid and decisive moves to cope with the direct effect of the problems in Asia by shifting capacity from routes which are not performing to others where we believe we can get a reasonable return,” says James Strong.³² He concedes that despite cutbacks and increased use of code sharing with Asian and Japanese Airlines, Asia remains a “lesser performing” area of the international network. Qantas’s exposure there continues to be sizeable with 180 flights a week into and between 16 cities.

Japan has become a problem after once being one of the airline’s mainstays. The Australia-Japan market that had accounted for 84 per cent of Qantas’s international profit prior to 1998 began operating at a loss in March 1998 and did so until March 1999. Qantas reacted by creating a code-share partnership with Japan Airline (JAL) on services out of Tokyo and Osaka to Cairns, Brisbane, and Sydney. Qantas also dropped one of its Sydney-Tokyo flights in August 1998 and its five weekly services to Fukuoka in October 1998.

The collapse of some Asian markets prompted Qantas by early 1999 to increase operations on more profitable routes to Europe and the United States. Additional capacity was transferred into the domestic business, which generated about 35 per cent of the group’s earnings, with Boeing 747s being deployed from Asia onto longer-haul routes connecting Sydney with Cairns and Perth. However, growth in the Australian market slowed considerably to low single figures by the beginning of 1998, with the primary cause being the sharp fall in Asian tourist numbers, particularly from Japan, Malaysia, Thailand, Korea, and Indonesia.³³

Decision Making and Governance Structure

In June 1999, the Qantas board of directors included:

- seven independent non-executive directors (including the chairman) elected by shareholders other than British Airways
- three non-executive directors who were appointed by British Airways (BA directors)—a result of the deal made when British Airways purchased a 25 per cent stake in Qantas
- two executive directors (chief executive and chief financial officer).

In fulfilling its responsibility to protect and enhance shareholder value, the Qantas board:

- sets and regularly reviews corporate strategies
- ensures appropriately skilled management is employed to implement these strategies
- identifies areas of significant business risk and ensures that management takes appropriate action to manage those risks
- supervises and monitors the operation of the business
- monitors management’s performance
- reports to shareholders
- manages specific risks related to financing, foreign exchange, fuel price and credit, including appropriate hedging strategies.

The audit committee assists the board in fulfilling its responsibilities regarding accounting and reporting practices of the Qantas group.³⁴ Four directors serve on the audit committee. Three (including the chairman of the audit committee) are independent non-executive directors and the fourth is a British Airways director. The audit committee usually meets four times a year. At each meeting, the committee members meet privately with the internal and external auditors.

³² Thomas, I. “The quiet roar,” *Air Transport World* (September 1998) pp. 40-47.

³³ *Ibid.*, p. 42.

³⁴ The Qantas group refers to Qantas and its subsidiaries.

The board places particular focus on the safety, environment, and security aspects of the airline. The committee on safety, environment, and security is responsible for monitoring operations related to these critical areas and reporting its findings. The committee receives detailed reports on all safety, environment, and security aspects and is charged with ensuring that appropriate procedures are in place to protect the airline, its passengers and the community. Three directors serve on this committee and its chairman is an independent non-executive. The other members are the chief executive (James Strong) and a British Airways director. The committee usually meets four times a year.

Recent Financial and Non-Financial Performance³⁵

Qantas earned an operating profit before abnormal items³⁶ and tax of \$478 million for the year ended 30 June 1998, an increase of 13.6 per cent over 1996/97. Profit after tax of \$305 million was 20.7 per cent higher than 1996/97. Sales and operating revenue of \$8.13 billion reflected growth of 3.8 per cent over the prior year. Passenger yield improved by 4 per cent overall and by 1.5 per cent after excluding favourable foreign exchange movements. Operating expenditures for the 1997/98 fiscal year were \$7.55 billion, an increase of 3.2 per cent over the prior year. The growth in costs was lower than the revenue growth due to the continued focus on cost containment and efficiency.

During the 1998 fiscal year, \$475 million in new cost reductions, cost avoidance, productivity, and revenue enhancement initiatives were achieved. These savings included \$150 million from improved labour productivity and manpower cost reductions, \$125 million attributable to reductions in materials and variable operating costs and \$124 million of savings in property sales, marketing, overhead, and other services costs. Industrial awards (government regulations setting workplace conditions) require Qantas to pay larger salaries to staff than those made by other regional airlines such as Air New Zealand and Malaysian. The industrial system in Australia generally is regarded as much less flexible than in many other countries. Managing Director, James Strong states "...you can't just walk out as they can in the US and say we are going to drop incomes by 15 per cent."³⁷

Overall, excluding the impact of unfavourable foreign exchange fluctuations, cost per ASK³⁸ fell by 1.4 per cent in the year ended 30 June 1998. Profits from domestic routes were higher than the prior year due to improvements in the mix of traffic and better yields. Domestic airline operations contributed \$213.4 million in Earnings before Interest and Tax (EBIT), an increase of 26.8 per cent over the previous year. Load factors were steady compared to the prior year.

International operations contributed \$271.9 million in EBIT, a result similar to the prior year. Excluding the effect of fluctuations in foreign exchange rates, international passenger revenues declined by 2.3 per cent over the prior year and RPK³⁹ decreased by 1.7 per cent. Yield, excluding favourable foreign exchange fluctuations, was down 0.7 per cent and load factors declined by 1.1 per cent. International freight performance was strong with revenue growth of more than 8 per cent. The favourable foreign exchange effect on revenues was offset by an adverse effect on foreign currency denominated expenditures during the year, producing a small net unfavourable foreign currency impact on total profits.

³⁵ The balance sheets and profit and loss statements for fiscal years ending 30 June 1997 and 1998 for Qantas are included in Appendix A.

³⁶ Abnormal items are items of revenue and expense included in the operating profit or loss after income tax for the fiscal year, which are considered abnormal by reason of their size and effect on the operating profit or loss after income tax for the fiscal year (*AASB 1018.09*).

³⁷ Gottlieb, R. and L. Schmidt. "Fight for the skies," *Business Review Weekly* (October 12, 1998) pp.76-80.

³⁸ See footnote 11.

³⁹ See footnote 10.

Subsidiary operations contributed \$96.4 million to the Qantas group's EBIT, an increase of 29.9 per cent on the contribution from the prior year. These increased returns were due to improved performances from regional airline operations, Qantas Flight Catering, and Qantas Holidays. All regional airlines recorded performance improvements from the prior year largely due to yield and load improvements. Internationally, services to the USA and the UK continued to be the best performers. Results from Asia were lower than the prior year with Europe and Africa recording slight improvements.

In fiscal year 1998,⁴⁰ net cash flows from operations totalled \$1.22 billion, up 9.7 per cent from the prior year, after including increased income tax payments of \$128 million. Excess cash generated was used to reduce net debt. The debt-to-debt plus equity ratio decreased from 96 per cent (i.e., 49:51) at 30 June 1997 to 66 per cent (i.e., 40:60) at 30 June 1998.

Capital expenditures for the year were \$673 million, an increase of 10.2 per cent over the prior year. This increase reflected additional expenditures on aircraft acquisitions (including progress payments), modifications and aircraft spares, and terminal improvements, notably the new domestic terminal in Sydney. Qantas is committed to a program of aircraft acquisition in line with its strategy of carefully managed expansion and entering new long-haul markets.

At the time of planning the 1999 audit the most recent financial figures for Qantas were for the half-year ended 31 December 1998 and showed a 34 per cent rise in net profit over the corresponding period to \$223 million. Revenue rose 2.5 per cent to \$4.3 billion. Earnings from international operations increased by 16 per cent despite a decline to the lowest level in a decade in overseas airfares. Qantas also announced in early 1999 that it hoped to stimulate revenues by maintaining and growing its existing customer base through expansion of its frequent flyer program via the **oneworld** alliance and the Qantas/Telstra credit card program.

Another interesting announcement is the intention to reduce distribution costs, which are about 20 per cent of its total costs. For example, Qantas set up a booking service on its Internet site so that customers can purchase tickets directly from the airline, thereby bypassing travel agents.⁴¹

To supplement the above financial data, key performance indicators from July 1996 to June 1999 are shown in Table 5.

⁴⁰ See Appendix B.

⁴¹ Morrison, Kevin. "Qantas leaves the profit pundits in its slipstream," *The Sydney Morning Herald* (February 20, 1999) p. 60.

Table 5 Qantas's Key Performance Indicators: July 1996 – June 1999								
	Passengers Carried ('000)		Revenue Passenger Kilometres (RPK) (m)		Available Seat Kilometres (ASK) (m)		Revenue Seat Factor (%)	
Jul-96 to June-97		18,606		59,199		81,440		72.7
Jul-97	1,677		5,366		7,074		75.9	
Aug-97	1,628		5,128		7,079		72.4	
Sep-97	1,591		4,937		6,802		72.6	
Oct-97	1,709		5,163		7,083		72.9	
Nov-97	1,579		4,828		6,826		70.7	
Dec-97	1,611		5,006		7,077		70.7	
Jan-98	1,620		5,265		7,092		74.2	
Feb-98	1,410		4,506		6,218		72.5	
Mar-98	1,577		4,833		6,770		71.4	
Apr-98	1,564		4,737		6,553		72.3	
May-98	1,447		4,373		6,586		66.4	
Jun-98	1,452		4,477		6,377		70.2	
Jul-97 to Jun-98		18,865		58,619		81,537		71.9
Jul-98	1,650		5,134		6,946		73.9	
Aug-98	1,613		4,984		6,924		72.0	
Sep-98	1,620		4,962		6,771		73.3	
Oct-98	1,729		5,202		6,963		74.7	
Nov-98	1,574		4,748		6,749		70.3	
Dec-98	1,607		5,125		7,037		72.8	
Jan-99	1,634		5,396		7,054		76.5	
Feb-99	1,468		4,671		6,299		74.2	
Mar-99	1,653		5,127		6,877		74.6	
Apr-99	1,588		4,953		6,706		73.9	
May-99	1,526		4,691		6,779		69.2	
Jun-99	1,574		4,870		6,660		73.0	
Jul-98 to Jun-99		19,236		59,863		81,765		73.2

(Source: www.qantas.com.au/company/finance/stats.html)

Qantas's Alliances

At the outset of the agreement, **oneworld** partners achieved the benefits of coordinated customer services, with easier transfers and combined frequent-flyer programs. Eventually, the partners will seek to reap the economic benefits from joint engineering services and equipment purchasing, including aircraft. Extending the alliance to include cargo operations also is being considered.⁴²

An indication of the relative size of the **oneworld** alliance members in 1998 is provided in Table 6:

	Passengers per Year (Millions)	Cargo per Year (Metric Tons)	Operating Revenues (Billions \$AUD)	Aircraft Fleet
American Airlines	93	679,633	16.9	856
British Airways	41	816,000	14.5	330
Canadian Airlines Int'l	11	114,168	2.0	131
Cathay Pacific Airways	10	635,000	3.9	62
Qantas Airways	19	359,000	4.8	145

Note: Financial figures are for the most recent complete fiscal year for each airline.

(Source: "oneworld at a glance" fact sheet, www.oneworldalliance.com/ accessed August, 1999)

More detailed operating statistics for the **oneworld** alliance members are included in Table 7 and the 1998 financials are included in Appendix A.

		1994	1995	1996	1997	1998
RPK						
Qantas	Km	46,854	51,204	54,627	59,199	58,619
BA	Km	81,907	87,395	96,163	102,304	106,739
American	Miles	N/A	N/A	104,710	107,026	108,955
Canadian	Miles	14,763	15,439	16,145	16,022	16,695
Cathay	Km	32,727	35,341	40,185	38,962	40,679
ASK						
Qantas	Km	65,019	71,225	75,930	81,440	81,537
BA	Km	116,974	122,063	130,286	139,789	149,659
American	Miles	N/A	N/A	152,886	153,917	155,297
Canadian	Miles	20,130	22,340	22,726	22,051	23,217
Cathay	Km	45,892	49,334	54,306	57,104	60,295
Load Factor (%)						
Qantas		72.1	71.9	71.9	72.7	71.9
BA		69.2	70.3	70.7	68.2	66.5
American		N/A	N/A	68.5	69.5	70.2
Canadian		73.3	69.1	71	72.7	71.9
Cathay		71.3	71.6	74	68.2	67.5

⁴² Morrocco, J.D., G. Thomas and B. Dormney. "oneworld Alliance To Expand Quickly," *Aviation Week & Space Technology* (September 28, 1998) pp. 32-33.

In addition to the oneworld alliance, Qantas is involved in a number of other alliances. As noted earlier, a long-standing alliance has been with British Airways. This alliance was formed in 1993 when British Airways purchased 25 per cent of Qantas and received Board membership. The key element of the alliance is a comprehensive 10-year commercial agreement that was enhanced when the airlines gained the approval of Australia's Trade Practices Commission (TPC) to cease competing and cooperate more closely on the "Kangaroo Route" between Australia, Asia, and Europe. The two airlines began code sharing between Australia and the UK via Singapore in 1997. In May 1998, they extended code sharing to include all flights to the UK via Bangkok. They also entered into code sharing agreements on some UK and Australian domestic flights in 1998. British Airways brings to Qantas its strong European and North Atlantic networks and its sizeable presence in the continental U.S.-Europe market. Qantas brings to the alliance a comprehensive Asia-Pacific network. Through this alliance agreement, both airlines benefit from savings achieved through joint purchasing of fuel, catering and catering equipment, and hotel accommodations, ground handling, and engineering spares. In addition, knowledge sharing and cooperation in many areas including in-flight services and entertainment, freight, information technology, and engineering has resulted in further gains. The alliance between Qantas and British Airways provides much stronger links between these two airlines through their respective links with the other oneworld alliance members.

Qantas also has a number of code-sharing arrangements with some non-oneworld airlines. It expanded code-sharing arrangements with Japan Airlines and signed new code-sharing agreements with Reno Air in the United States, Emirates Airlines to Dubai, Vietnam Airlines to Ho Chi Minh City, Aerolineas Argentinas to Buenos Aires, and Swissair to Zurich. These arrangements are mainly restricted to a small number of routes and do not involve joint marketing arrangements.

In addition to airline alliances, Qantas has established co-branded credit cards (e.g., the Qantas Telstra ANZ Bank Visa card). These programs, together with alliances with hotels and car rental companies, provide a source of revenue for Qantas who receives a commission in return for providing frequent flyer points for purchases. Qantas also is establishing strategic alliances in information technology and telecommunications areas that are expected to provide benefits for e-commerce development.

Main Global Alliance Competitor: Star Alliance

In May 1999, Ansett Australia⁴³ joined Air Canada, Air New Zealand, Lufthansa, SAS, Thai Airways International, United Airlines, and Varig as part of the Star Alliance. Ansett also has a relationship with Singapore Airlines via Air New Zealand's agreements with Singapore Airlines. These relationships provide Ansett with international resources and allows it to compete with Qantas more effectively.

When Graham Eddington took over as managing director of Ansett in January 1997, he told his employees that the airline must participate in globalisation or decline. Eddington stated that Ansett now is a "virtual" player in the world airline game.⁴⁴ The Star Alliance and the resources of Singapore Airlines put Ansett into the global market with minimal resources beyond its domestic fleet, which is estimated to carry 46 per cent of the interstate traffic. With only three aircraft

⁴³ See Appendix C for Ansett's financial statements.

⁴⁴ Sandilands, B., "Ansett's 'virtual' global future." *Business Review Weekly* (April 9, 1999) pp. 64-65.

dedicated to international flights in June 1999 (to Denpasar, Hong Kong, and Osaka), the Ansett brand is being applied to 28.6 per cent of the market for travel to and from Australia through its membership in the Star Alliance. This coverage compares to Qantas, which has 51 wide-body jets flying its routes in the oneworld alliance and commands 49.2 per cent of Australia's inbound and outbound air travel markets.

Eddington stated:

The virtual airline concept is absolutely vital to Ansett's future. It means putting our brand on the services of other carriers in the Star Alliance in order to provide our passengers with global travel solutions. It means that we can do things in terms of services that our balance sheet is not strong enough to allow us to do in our own right (such as ordering new planes). It means providing our Star Alliance marketing partners with services in our region they could not or might not offer. We have to think of ourselves as a brand that has customers rather than an airline that has planes.⁴⁵

Eddington reinforced his definition of "virtual" by telling staff that Ansett would not outsource its engineering division because it was essential that Ansett have total control over maintenance and safety. He also mentioned that Ansett plans to build its international fleet only to the extent that it is profitable and never to equal the size of Qantas.

According to Dr. Cheong, chief executive of Singapore Airlines, Singapore Airlines will step-up its investment, if necessary. Cheong says Singapore will "nurture" Ansett into becoming a more substantial international carrier.⁴⁶ The mechanism appears to be that Ansett will have the backing to apply for unused or "shelf" capacity in existing air treaties to fly routes using jets leased from Singapore Airlines. Ansett has applied to the International Air Services Commission for 3,500 seats a week to Europe, to be code shared with Singapore Airlines. Ansett's international operations currently are 51 per cent owned by Australian institutions and 49 per cent by Air New Zealand, a formula that satisfies bilateral air-treaty requirements that a flag carrier be majority owned by the country of origin.⁴⁷

The Ansett alliances have created additional competition for Qantas and some concerns have been expressed about government policy in the area. Strong feels that government policy has favoured Ansett over Qantas and he is particularly sensitive about the link to Singapore Airlines. He states:

Liberalisation in Australia means that somebody like Singapore Airlines is actually encouraged by the Australian Government to come down here and invest and form alliances with an Australian operator such as Ansett and a New Zealand operator. It ends up with them being able to combine the New Zealand market, the Australian market and Singapore, one of the great hubs in the world... We now have an opposition group who actually are based on three home markets and we can't get into Singapore, we can't set up an airline in Singapore.... The Government's attitude is un-Australian. This is not about us trying to protect our markets, it's about where is the equivalent access. It's about being given access through the markets in Asia to beyond, known as fifth freedoms.⁴⁸

Table 8 provides operating statistics for the Star Alliance covering the period 1994 to 1998.

⁴⁵ *Ibid.*, p. 64.

⁴⁶ *Ibid.*, p. 65.

⁴⁷ *Ibid.*, p. 64.

⁴⁸ Gottlieb, R. and L. Schmidt. "Fight for the Skies," *Business Review Weekly* (October 12, 1998) pp.76-80.

Table 8 Operating Statistics for Members of the Star Alliance From 1994-1998 ⁴⁹						
		1994	1995	1996	1997	1998
RPK						
Ansett	Km	12,020	13,911	15,469	17,020	17,230
Air NZ	Km	15,597	17,723	20,113	20,281	19,609
Air Canada	Miles	N/A	N/A	N/A	22,788	23,211
Lufthansa	Km	N/A	N/A	N/A	N/A	74,668
SAS	Km	18,466	18,506	19,487	20,339	20,883
Thai	Km	N/A	N/A	N/A	N/A	N/A
United Air	Miles	108,299	111,811	116,697	121,426	124,609
Varig	Km	N/A	N/A	N/A	N/A	N/A
ASK						
Ansett	Km	15,929	19,768	22,292	24,988	25,372
Air NZ	Km	22,043	25,806	29,693	29,693	28,995
Air Canada	Miles	N/A	N/A	N/A	32,061	32,719
Lufthansa	Km	N/A	N/A	N/A	N/A	102,354
SAS	Km	28,154	28,447	30,646	31,333	31,766
Thai	Km	N/A	N/A	N/A	N/A	N/A
United Air	Miles	152,193	158,569	162,843	169,110	174,008
Varig	Km	N/A	N/A	N/A	N/A	N/A
		1994	1995	1996	1997	1998
Load Factor (%)						
Ansett		75.46	70.37	69.39	68.11	67.91
Air NZ		66.6	65.65	64.8	64.85	63.85
Air Canada		N/A	N/A	N/A	71.1	70.4
Lufthansa		N/A	N/A	N/A	N/A	65.7
SAS		61.8	61.3	58.5	59.9	60.1
Thai		N/A	N/A	N/A	N/A	69.4
United Air		71.2	70.5	71.7	71.8	71.6
Varig		N/A	N/A	N/A	N/A	N/A

(Source: www.star-pr.com, accessed as at August 1999)

Note: Other major airline alliances at June 1999 are Worldperks Global Alliance (including Northwest, KLM, Continental, Alaska Airlines, Air China, Japan Air System) and the Qualiflyer Alliance (including Swissair, Sabena and Austrian Airlines, AOM French Airlines, Crossair, Lauda Air, and Tyrolean Airways). These alliances are rather fluid. Delta used to be a member of Qualiflyer but ceased its alliance and has pursued an alliance with Air France to produce a stronger presence in Latin America because of Air France's marketing alliance with Aeromexico. (As an aside: On 16 April 1999, Delta Airlines suspended its code share with Korean Airlines (KAL) pending a thorough review of KAL's operations. That decision was made in light of operational incidents including a recent loss of a MD-11 cargo aircraft in China.

⁴⁹ The Star Alliance was formed in 1997.

Appendix A: oneworld's Financial Statements

Profit and Loss Statement (converted to \$AUD)

	Qantas 30/6/97	Qantas 30/6/98	American 31/12/98	Cathay Pacific 31/12/98	British Airways 31/3/98	Canadian Airways 31/12/98
Turnover (sales from operations)	7,834.4	8,131.5	28,998.3	5,686.0	22,287.7	3,425.0
Operating profit before interest and tax	517.2	581.7	3,981.9	84.6	1,929.1	(61.2)
Net interest expense	(96.3)	(103.7)	(385.6)	(66.2)	(433.3)	(84.9)
Profit from operations	420.9	478.0	3,596.3	18.3	1,495.8	(146.1)
Abnormal items before tax	(17.2)	-	-	(185.1)	-	-
Operating profit before tax	403.7	478.0	3,596.3	(130.1)	1,495.8	(146.1)
Tax	(151.0)	(173.0)	(1,425.9)	22.2	(343.0)	(2.5)
Operating profit after tax	252.7	305.0	2,170.4	(108.0)	1,152.8	(148.6)
Outside equity interest	-	(0.2)	-	(7.5)	33.5	-
Income from discontinued operations	-	-	13.3	-	-	-
Operations profit after tax attributable to members of chief entity	252.7	304.8	2,183.7	115.4	1,186.3	(148.6)
Retained profits (opening balance)	824.9	947.4	5,682.0	3,776.5	4,825.3	(464.5)
Movements in retained profits	(2.2)	-	-	(4.3)	(98.0)	-
Total available for appropriation	1,075.4	1,252.2	7,865.7	3,656.8	5,913.6	(613.1)
Dividends	(128.0)	(158.1)	-	(72.2)	(453.9)	-
Total retained profits	947.4	1,094.1	7,865.7	3,584.6	5,459.7	(613.1)

Appendix A: oneworld's Financial Statements (continued)

Balance Sheet (\$AUD)	Qantas	Qantas	American	Cathay Pacific	British Airways	Canadian Airways
	30/6/97	30/6/98	31/12/98	31/12/98	31/3/98	31/12/98
Current Assets						
Cash	53.5	121.4	3,445.1	743.1	129.0	326.6
Receivables	1,831.1	1,723.0	2,564.3	701.0	3,693.1	289.1
Inventories	149.5	207.5	990.5	147.8	193.4	133.2
Other	34.1	56.8	1,101.8	1,882.2	1,774.4	57.2
Total current assets	2,068.2	2,108.7	8,101.7	3,474.2	5,789.9	806.1
Non-Current Assets						
Receivables	1,846.1	2,218.1	-	272.0	-	-
Investments	16.6	38.6	-	282.2	1,000.7	82.3
Property plant & equipment	5,807.2	5,913.4	23,907.9	10,479.8	22,352.2	1,107.3
Intangibles	30.3	28.6	2,040.8	-	-	-
Other	83.7	51.4	3,014.7	-	-	270.8
Total non-current assets	7,783.9	8,250.1	28,963.4	11,034.0	23,352.8	1,460.4
Total Assets	9,852.1	10,358.8	37,065.1	14,508.3	29,142.7	2,266.5
Current Liabilities						
Accounts payable	1,331.5	1,599.0	1,914.5	1,111.9	2,579.0	657.6
Borrowings	541.9	193.9	79.8	227.1	711.8	92.0
Provisions	550.3	559.1	-	-	319.8	-
Revenue in Advance	647.7	804.8	3,594.7	350.2	1,880.1	280.3
Leases	-	-	255.9	289.7	250.2	-
Deferred items	46.4	51.1	-	1,757.7	-	-
Other	-	-	3,526.5	193.8	1,534.5	-
Total current liabilities	3,117.8	3,207.9	9,371.4	3,930.3	7,275.4	1,029.9
Non-Current Liabilities						
Borrowing	2,835.7	2,975.6	4,048.4	899.5	10,107.2	996.6
Provisions	760.4	805.4	2,740.5	-	77.4	-
Deferred lease benefits/income	440.7	377.6	2,931.6	4,395.3	2,973.6	-
Other	26.5	29.9	6,842.0	23.0	144.4	59.8
Total Non-Current Liabilities	4,063.3	4,188.5	16,562.4	5,317.8	13,302.5	1,056.5
Total Liabilities	7,181.1	7,396.4	25,933.8	9,248.1	20,577.8	2,086.3
Net Assets	2,671.0	2,962.4	11,131.3	5,260.2	8,564.9	180.1
Shareholders' Equity						
Share Capital	1,111.7	1,177.3	5,412.8	144.0	670.5	440.5
Treasury Shares at cost	-	-	(2,140.5)	-	-	-
Reserves	609.9	689.0	(6.6)	1,531.7	2,434.6	-
Retained Profits	947.4	1,094.1	7,865.7	3,584.6	5,459.7	(613.1)
Preferred Shares of Subsidiary	-	-	-	-	-	352.7
Outside Equity Interests	2.0	2.0	-	-	-	-
Total Shareholders' Equity	2,671.0	2,962.4	11,131.3	5,260.2	8,564.9	180.1

Appendix B: Qantas's Statement of Cash Flows

FOR THE YEAR ENDED 30 JUNE 1998

	CONSOLIDATED		CHIEF ENTITY	
	1998	1997	1998	1997
	\$ m	\$ m	\$ m	\$ m
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	8,194.3	7,851.4	7,263.6	6,795.0
Payments to suppliers and employees	(6,773.6)	(6,668.5)	(6,147.7)	(5,943.9)
Interest received	96.5	99.4	95.4	102.6
Interest paid	(187.6)	(202.8)	(168.8)	(179.1)
Dividends received	17.8	32.3	67.1	111.4
Income taxes paid	(129.0)	(1.0)	(83.7)	(0.5)
Net cash provided by operating activities (refer note 36)	1,218.4	1,110.8	1,025.9	885.5
CASH FLOWS FROM INVESTING ACTIVITIES				
Payments for property, plant and equipment	(673.0)	(610.6)	(451.7)	(569.4)
Payments for aircraft security deposits	(13.6)	(14.2)	(14.3)	(13.4)
Total payments for purchases of property, plant, equipment and aircraft security deposits	(686.6)	(624.8)	(466.0)	(582.8)
Proceeds from sale of equity investments	-	371.5	-	-
Proceeds from sale of property, plant and equipment	40.6	2.2	12.9	5.7
Proceeds from sale and leaseback of non-current assets	-	215.3	-	215.3
Payments for investments, net of cash acquired	(22.0)	(44.3)	(21.6)	-
Loans repaid by other entities	-	9.0	-	4.6
Net funding from/(to) related parties	-	-	(107.9)	421.1
Net cash provided by/(used in) investing activities	(668.0)	(71.1)	(582.6)	63.9
CASH FLOWS FROM FINANCING ACTIVITIES				
Repayment of borrowings/swaps	(571.5)	(569.8)	(510.1)	(516.2)
Debt prepayments on sale and leaseback transactions	(76.5)	(251.7)	(76.5)	(251.7)
Total debt repayments	(648.0)	(821.5)	(586.6)	(767.9)
Proceeds from borrowings/swaps	55.7	77.2	53.0	74.5
Proceeds from issue of shares	36.7	40.1	36.7	40.1
Dividends paid	(36.7)	(40.1)	(36.7)	(40.1)
Net cash used in financing activities	(592.3)	(744.3)	(533.6)	(693.4)
RECONCILIATION OF CASH PROVIDED BY/(USED IN):				
Operating activities	1,218.4	1,110.8	1,025.9	885.5
Investing activities	(668.0)	(71.1)	(582.6)	63.9
Financing activities	(592.3)	(744.3)	(533.6)	(693.4)
Net increase/(decrease) in cash held	(41.9)	295.4	(90.3)	256.0
Cash at the beginning of the financial year	752.6	457.2	443.2	187.2
Cash at the end of the financial year (refer note 36)	710.7	752.6	352.9	443.2

Appendix C: Ansett's Financial Statements

	1998	1997
Key Consolidated Profit Figures		
Operating Revenue	3,505,407	3,395,584
Operating Profit/Loss before Abnormal Items and Income Tax	59,759	19,487
Operating profit/(loss) before Income Tax	82,210	(11,421)
Operating Profit(Loss) after Income Tax Attributable to Members of the Company	<u>29,529</u>	<u>(35,028)</u>
Key Consolidated Balance Sheets		
Current Assets		
Cash	517,036	302,619
Receivables	715,909	658,387
Inventories	40,320	30,313
Other	62,034	46,066
Total Current Assets	<u>1,335,299</u>	<u>1,037,385</u>
Non-Current Assets		
Receivables	111,749	171,229
Investments	28,233	64,515
Property, plant and equipment	2,449,565	2,598,758
Other	220,242	36,758
Total Non-Current Assets	<u>2,809,789</u>	<u>2,871,260</u>
Total Assets	<u>4,145,088</u>	<u>3,908,645</u>
Current Liabilities		
Accounts payable	1,012,394	884,980
Borrowings	419,148	307,320
Provisions	217,564	208,749
Other	14,789	13,875
Total Current Liabilities	<u>1,663,895</u>	<u>1,414,924</u>
Non-Current Liabilities		
Accounts payable	163,843	147,467
Borrowings	1,367,506	1,383,389
Provisions	408,739	399,951
Other	3,827	22,176
Total Non-Current Liabilities	<u>1,943,915</u>	<u>1,952,983</u>
Total Liabilities	<u>3,607,810</u>	<u>3,367,907</u>
Net Assets	<u>537,278</u>	<u>540,738</u>
Shareholder's Equity		
Share capital	50,116	50,116
Reserves	656,244	545,724
Accumulated losses	(184,946)	(68,147)
Outside equity interests in controlled entities	15,864	13,045
Total Shareholder's Equity	<u>537,278</u>	<u>540,738</u>

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