Remarks of Tony Tyler at the Auckland Breakfast Briefing, 2 July 2013

Kia Ora, Good morning! It is a real pleasure to be in Auckland and hosted to this very nice breakfast by Air New Zealand—a proud and longstanding member of IATA.

In a few months—on 1 January 2014 to be exact—we will celebrate a century of commercial flight. In a brief 100 years, the air transport industry that grew from the first flight of Tony Janus from St. Petersburg to Tampa has changed our world enormously.

Connectivity, enabled by aviation, has turned our planet into a global community. We take it for granted that exotic fruits appear in Auckland's grocery stores and that New Zealand produce is sold around the world. We don't think twice about another international blockbuster being filmed in this beautiful country. Innovative Kiwi companies do business in global markets. All the while personal connections and cultural ties crisscross the globe and strengthen day-by-day.

That's only the tip of the iceberg in describing what aviation has enabled. If you quantify aviation's benefits, the results are impressive.

Globally, aviation supports some 57 million jobs and $2.2 trillion in economic activity. About $6.4 trillion of goods traded internationally are transported by air. Over half of global tourists arrive by air—closer to 100% for New Zealand. In fact tourists are a major component of the 3 billion passengers that will fly this year. Looking specifically at New Zealand, aviation and related tourism supports nearly 260,000 jobs and over NZ$21billion of economic activity. That's 11.5% of New Zealand's GDP and 12% of the workforce.

In my meetings with the government yesterday, it was very clear that they value the contribution of aviation to New Zealand's economy and are eager to support its successful development. This country has a great reputation in the aviation world that is fully deserved for its pragmatic approach. This was recently demonstrated again with New Zealand signing on to the Agenda for Freedom policy principles on industry liberalization.

It is refreshing to see a government that is so aware of aviation's important role. In many cases the value that this industry delivers is taken for granted.

Much of the credit for that can be attributed to the industry's constantly improving safety record. Last year was the safest year ever for air travelers. The most common measure for aviation safety is tallying the accidents where Western-built jet aircraft have become irreparable. We call these Western-built jet hull losses. In 2012 there were no such accidents among our 240 member airlines or among the 380+ airlines that were on the registry of the IATA Operational Safety Audit (IOSA). This includes all of our members for whom IOSA is a requirement. Safety is, of course, a never-ending challenge. And constant improvement, even on last year's great result, is the goal.

We also have a great challenge in terms of industry profitability. In 2012, airlines made about $2.50 for every passenger carried. That generated a net profit margin of 1.1%--or a $7.6 billion return on $680 billion in revenues.

It's a pitiful return, but if you put it in historical context, making any money at all under current conditions—with a weak global economy and high oil prices—is an amazing achievement. In 2006 airlines achieved the same 1.1% net profit margin, but with oil prices that were about half of today's prices and the global economy growing at 4%--about double what we are experiencing today.

Airlines are driving profitability in difficult times with efficiency. Load factors are around 80%—a record high. Only a decade ago the benchmark was around 70%. And airlines are working in strong global partnerships—providing ever greater connectivity. With 40,000 city pairs linked by air, it has never been easier to get where you want to be.

The bottom line is even improving—slightly. In 2012, the $2.50 per passenger that airlines earned was enough to buy a cup of coffee in most places. This year we expect a 1.8% net profit margin. If we are right, the industry will earn on average $4 per passenger. That may be enough for a sandwich—but it is nowhere near the returns that our investors expect.
To keep up with the growing demand for connectivity, over the next 20 years we will need to attract financing to support aircraft orders in the range of $4-5 trillion.

There is no easy answer to how airlines can achieve sustainable levels of profitability. But today I would like to discuss three critical components to securing aviation's future:

- Cost-efficient infrastructure that can support aviation's important mission
- A distribution system that meets customer needs, and
- A global approach to manage aviation's environmental impact

Cost Efficient Infrastructure

Let's start with the basics—infrastructure. Having a great fleet of planes has very little meaning without airports from which to operate. And equally, we would not get very far without air navigation systems to guide the planes to their destinations. Airports, air navigation service providers and airlines are partners.

The numbers tell us that we are cooperating very well on safety. And it is certainly the case in New Zealand that the infrastructure is accommodating growth. For example I am pleased to hear that Auckland Airport is reviewing its master plan. Before anything is decided, it will be critical to ensure that the airlines are fully consulted. It is important that the right investments are made at the right time and with the right costs. And it should also be accompanied with a strong reminder to all involved of the economic and social benefits of meeting the needs of connectivity—particularly for an island nation located many thousands of kilometers from its trading partners.

While that is moving in the right direction, I do see an issue with the cost of infrastructure. New Zealand has taken a very light-handed approach to economic regulation and the results have not been satisfactory. Frankly, I think that the traveling public is suffering as a result.
I spent yesterday in Wellington meeting with the government. That gave me the opportunity to see and use Wellington airport. In February the Commerce Commission announced that it is expecting the airport to make a return of at least 12.3% and possibly as high as 15.2%. That's significantly above the 7-8% that the Commission set as the appropriate level of return.
Over the next five years, the airport will collect up to $69 million more than it needs to in order to meet what the Commission believes is an appropriate level of return.

The same Commission calculated that Auckland airport is making a reasonable return. But we believe that the evaluation criteria for assets and reasonable return paint a picture that is very different from reality.

I don't want to bore you with complicated calculations. But I do want to encourage you to take a good look at the process. The Commerce Commission clearly found that Wellington airport was behaving badly. But it did not have the teeth to do anything about it. And in the case of Auckland, there is no process to agree on the relevant criteria for important elements such as the cost of capital.

As members of New Zealand's business community you have some skin in the game. Connectivity is the lifeblood of the New Zealand economy. Anything that makes connectivity more expensive than it needs to be is a knock on competitiveness.

Intense competition keeps airline fares in check. But a much stronger hand of government is needed for infrastructure providers than exists today. In fact, the Airport Authorities Act of 1966 basically says that airports can price as they see fit. Certainly this should evolve to a structure that forces airports and their airline customers to reach fair commercial agreements.

This same concept should also include Airways New Zealand. It is a past winner of the IATA Eagle Award in recognition of the enormous reform efforts that it went through a decade or so ago as it corporatized. In fact, its accomplishments were so significant that it's then CEO, Ashley Smout, became a global leader in air navigation circles. This well-deserved good reputation was built on effective collaboration with its customers—the airlines.

Unfortunately, that reputation is at risk. From yesterday a 10.6% fee hike took effect. Further planned increases will see a total fee increase of 15.7% by 2015. This is a big problem for airlines and a departure from the partnership built-up since corporatization. It certainly does not reflect the industry's focus on managing costs and improving efficiency. I should be clear that airlines are willing to pay for efficiencies. In fact there is still a lot that could be accomplished by Airways New Zealand in that area. But such decisions must be the result of a robust discussion and an agreement—rather than a heavy handed decision by an infrastructure provider enjoying a monopoly position.

I met with Ed Sims, the current CEO yesterday. And I take on board that he has some big challenges to ensure the long-term viability of Airways. But we are results focused. And an increase of this magnitude,

no matter how you look at it, is not a good result.
This may be another clear case where the hand of government—protecting the national interest—needs to be felt a bit more strongly by requiring consultation leading to agreement. In the meantime, we urge Airways New Zealand to work rigorously on cost efficiencies (as airlines have done and continue to do) and share the benefits with airlines by minimizing or even avoiding the price increases.

Distribution

Along with strengthening partnerships with our infrastructure providers, the industry must improve its distribution capability. Airlines sell tickets in two ways—directly and through travel agents. That is not unusual. Most, if not all products are distributed through several channels. People shop in different ways and having multiple channels is a way of responding to customer needs.

But there is something unusual in airline distribution. If you buy an Apple computer from the Apple website or an Apple re-seller, you get the same range of products. But with air travel products you are more likely to have a richer shopping experience on the airline's website than you will when buying via a travel agent.

Let me give you a quite well-known example. Air New Zealand is famous for its many innovations—one of which is the Sky Couch. It's a product that no other airline offers. You can buy it on their website. But it is very difficult to purchase through a travel agent.

Why?

Well, the answer has several decades of history. Airlines were among the first industries to develop global distribution systems for very practical reasons. For example, Air New Zealand, based in Auckland, needed to be able to sell its seats not only here, but in Japan, Australia, the US, Europe—indeed even in places where it did not fly. And so the airline industry developed the first computer reservation systems. These performed the vital function of linking thousands of travel agents to hundreds of airlines across the world. And these systems communicated in what was then a cutting edge messaging standard known as EDIFACT.

If you need to travel, the system presents you (through your travel agent) with options based on price, route, class and schedule. It's a great system, but the world of merchandizing has changed with the evolution of the internet and the development of XML—the new lingua franca of modern commerce.

IATA's raison d'être is to set global industry standards. We do it in many areas from safety to e-ticketing. And we are working to set the standards for a New Distribution Capability—or NDC—that is based on XML messaging standards. I admit, the name and description of this initiative are not the most engaging. But what the standard could enable for future travelers is very exciting.

By bringing modern merchandizing capabilities to the selling of airline products, we will enable much richer comparison shopping. Features could include Wi-Fi availability, duty-free shopping, specialty food and beverage services…or literally anything that adds value to a traveler's experience. And, the standard will also be able to accommodate pictures, so that you can actually see what you are buying.

NDC will also bring greater pricing transparency. Today, if you go to a travel agent, they can accurately compare base fares. With some effort, they could calculate some ancillary options. But pulling together all the information to produce complete offers is nearly impossible—particularly if you add in the perks of loyalty program status. The NDC standard will not only bring more transparency to this, it could even facilitate personalized offers—if, and only if, the passenger chooses to identify him-or-herself.

When you create a standard, you unleash innovation and create the possibility for new value streams to develop. That's great for customers. They will be the judge of what is successful and what is not. I believe that it is also going to give enormous opportunities to travel agents. They will have much more information on which to base their advice to customers.

IATA's role is to set the standard—which we are doing collaboratively with a broad cross-section of industry players. Already we have interest by some to use the standards in pilot projects that will be live by the end of the year. If the market response is positive—and having seen some demonstrations, I cannot see why it would not be—I hope that you will be able to enjoy an air travel shopping experience that is as rich as you have come to expect in almost all other areas of retail.

Environment

The last element that I would like to discuss with you today may be the most critical for aviation's future—the challenge of managing aviation's carbon emissions. Airlines are a fuel intensive industry. About a third of our cost structure is fuel. And in burning that fuel, airlines emit carbon—some 680 million tonnes a year or 2% of global manmade carbon emissions.
The airline industry recognizes that, as with any industry, its future is predicated on sustainability. We have taken-up the challenge. The industry—airlines, airports, air navigation service providers and manufacturers—established clear targets:

- To improve fuel efficiency by 1.5% annually to 2020
- To cap net emissions from 2020 with carbon-neutral growth (CNG2020)
- And to cut emissions in half by 2050 compared to 2005.

As far as I am aware, no other global industry has set such an ambitious global agenda. And we have agreed a four pillar strategy to achieve it.

The first three pillars are focused on actual reduction in emissions—through better technology, more efficient operations and infrastructure. There have been significant successes. New aircraft such as the Boeing 787 and the Airbus A380 are about 20% more fuel efficient than their predecessors. Airlines—including Air New Zealand—are literally lining-up to invest in more fuel-efficient fleets both with new aircraft and modifications to existing models. And advancements in air traffic management are helping to get all aircraft to their destinations more efficiently. The Aspire project—linking key routes in Southeast Asia, Oceania and the West Coast of North America—is a great example that involves Air New Zealand, Airways New Zealand and many other partners.

We are even making progress on low-carbon alternative fuels, such as sustainable biofuel. A decade ago, aviation had no alternative to traditional jet kerosene. Air New Zealand is among carriers that collectively have safely operated over 1,500 commercial flights using such fuels. Airlines are eager to do more. But supplies are limited and the price is not yet commercially viable. As governments have done with other forms of alternative energy, the biofuel industry needs some government economic incentives in order to grow production levels that will drive costs down.

The last pillar of our strategy focuses on market-based measures. This is critically important to our short-term goal of CNG2020. With the best will in the world, we will not meet this target without access to market-based measures.

Not just any measure will do. It must, among other things, be global, transparent, and ensure that airlines pay for their carbon once—not several times over. The reasoning for that was clearly demonstrated last year. Europe's plan to extra-territorially include international aviation in its emissions trading scheme (EU ETS) brought us to the verge of a trade war.

Fortunately, Europe stopped the clock on implementation. And that created the space for governments to focus on finding a solution through the International Civil Aviation Organization (ICAO). The politics of climate change are complex. And even with the pressure of EU ETS removed, finding a global solution through ICAO will be challenging.

As a responsible industry, airlines are doing everything possible to help governments in their difficult task. A month ago at our Annual General Meeting, airlines overwhelmingly agreed to a resolution on market-based measures that should support their efforts. The industry sent a clear signal to governments that we would prefer a mandatory off-setting scheme as a single measure to manage emissions growth over the 2020 baseline. We see it as the simplest, fastest and most cost-effective solution. And airlines went a step further to agree principles for how to most equitably share that cost. This is a ground-breaking agreement—ahead of all other industries at the global level. There is still some work to do in turning the principles into practical applications—particularly ensuring as much fairness as possible between fast growing airlines in emerging markets and those growing more slowly in mature markets. But I am confident that will come.

The focus is now on ICAO. The environment will be at the top of the agenda at the ICAO Assembly in September. And I hope that we can count New Zealand among the states supporting the industry position.

Conclusion

Infrastructure, distribution and sustainability are only a sampling of the many challenges facing aviation. Getting them right will help build a solid platform for the future growth of connectivity—something that I am sure is close the hearts of all New Zealanders. Economically, aviation bridges the gap with your many trading partners and makes it possible for visitors to see the wonders of Aotearoa. And it plays a huge role in New Zealand's national psyche—facilitating the tradition of the "big OE", linking Polynesian families and helping Kiwis explore and experience the world.

IATA's vision is to be the force for value creation and innovation driving a safe, secure and profitable air transport industry that sustainably connects and enriches our world. That's a tall order. And success will require the support of strong partnerships—with governments and across the business community. The first century of commercial aviation is marked by enormous transformational change in the way that we live and work together as a global community. I hope that you will share and support the optimism for the development of the second hundred years of global connectivity.