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SCHOOL OF BUSINESS
GRADUATE PAPER SERIES NO. 5

SHOULD QANTAS BE PRIVATISED,
AND IF SO, HOW?

SCHOOL OF BUSINESS

By Richard Neish



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EXECUTIVE SUMMARY & RECOMMENDATIONS IN BRIEF

As a result of the detailed analysis in this report of the issue of whether QANTAS Airways Limited should be privatised, it is my opinion that:

- (a) QANTAS should be fully privatised as soon as possible with the Australian Government giving full assistance during the transition period.
- (b) The International Airline Industry should be partially deregulated in the near future to ensure more healthy competition between international air carriers operating into and out of Australia via the various Air Services Agreements with other countries, and
- (c) QANTAS must ensure it remains competitive after privatisation by aggressively marketing itself in Australia and overseas, and ensuring it minimises its operating costs on a continuing basis.

STATEMENT OF OBJECTIVES

This report analyses the future possibility of the Privatisation of QANTAS AIRWAYS LIMITED, Australia's International Airline which at present is wholly owned by the Commonwealth of Australia. There has been a great deal written and discussed in the media, in Parliament and in the Private Sector in general, especially in the last five years, about the long term benefits to Australia by the Privatisation of QANTAS and the possible less attractive results of privatisation. This report will analyse many of these statements and put them in perspective to the real issues involved. Specifically the report will:

- (a) Identify what privatisation means in general and the possible different forms or degrees of privatisation.
- (b) Analyse the present market structure of QANTAS, its recent performance and efficiency of operations and its future market prospects.
- (c) Outline the arguments for privatisation of QANTAS.
- (d) Advance arguments against privatisation and an analysis of such arguments.
- (e) Recommended form of privatisation for QANTAS.
- (f) Analyse the future impact of privatisation on the operations of QANTAS and the likely public reaction.
- (g) Indicate the probable long term effects on the airline industry and the Australian economy as a whole if QANTAS is privatised, and
- (h) A Conclusion and Policy Recommendations will be advanced.

INTRODUCTION

"Privatisation" has become a major issue in many countries around the world especially in the last 10 years and it is a term often used by the private sector as a solution to the seemingly ever increasing size of the Government (Public) Sectors in their economies which they consider are far too inefficient in general to warrant the great amounts of resources both in monetary and human terms required to operate those public utilities.

But is Privatisation the ideal solution to the expanding public sector in Australia? The answer seems to be that it may provide some solutions for particular public sector industries that may be suited to privatisation but on the other hand it may have a detrimental effect to the consumers in society over the long term in certain industries such as for natural monopolies; for example: water supply.

WHAT IS PRIVATISATION AND WHAT FORMS MAY IT TAKE?

"Privatisation usually means the transfer of activities and assets from the public to the private sector. This can be effected directly in two main ways:

- (i) *by the sale of public assets, and*
- (ii) *by contracting out the production of publicly financed goods and services to the private sector."*

So Privatisation may not necessarily require the sale in full of the public enterprise to the private sector and in many cases this may be very undesirable to do so as it may just transfer a public monopoly into a private monopoly with the possible result that the consumer may end up paying higher prices than previously due to increased profits being the goal of the new private entity.

Afterall, the issue of privatisation surely is the ultimate effect it has on the consumers of that product or service the entity is supplying and not just in monetary terms, but also in social, political, environmental, and cultural terms as well.

There is a perception in the private sector that if a product or service is provided by the public sector it could not be supplied as efficiently as the private sector could provide it and this is probably true for many public sector utilities, but each utility is different and the decision to privatise and the form of privatisation must be evaluated on an individual utility by utility basis, especially in relation to the long-term effects of such privatisation on society as a whole.

Forms of Privatisation

Privatisation may take many possible forms from complete selling of the whole public sector entity to the private sector usually by a share float on the Stock Exchange, to varying degrees of partial private ownership of shares eg. 49% and the rest retained by the Government (51%); to minimal Government ownership eg. 10% and the majority privately owned. Situations could arise where existing employees of the Government owned enterprise may become shareholders and thus become more identified with the enterprise than previously, with the possible result of productivity gains.

The private sector naturally would consider that there is no substitute for the profit-motive in maximising the efficiency of operating any enterprise whether private or public. This view certainly has a great deal of credence because private

enterprise endeavours to maximise revenues and minimise costs and maximise productivity per employee. Private enterprise also tends to use the Incentive scheme as a basis for productivity gains which in many public utilities has tended to be overlooked due to in many cases lack of direct competition which, due to market forces, tends to ensure private enterprise operates at its most efficient levels.

Of course many public entities such as Australia Post offer a service to the public to very remote areas of Australia at a loss which they can do by 'cross-subsidisation' of profitable routes against unprofitable ones. This is one of the major arguments given against privatisation of certain public utilities; that if the private sector were to run these utilities, then only the profitable routes would be retained and the consumers in the more remote, disadvantaged areas would suffer. This will be analysed in relation to QANTAS later in this report.

Corporatisation & Commercialisation

Other alternatives to full privatisation that have been given are those of:

- (i) Corporatisation, and
- (ii) Commercialisation

Corporatisation is where the Government would retain ownership of the public utility but it would be operated like a private enterprise business by having a private enterprise style of management with much less government control over their operations such as asset acquisition, investment decisions, and market penetration strategies. Both QANTAS and Australian Airlines have to some extent been corporatised in their recent past where the enterprises have been quite successful in competing in the open competitive market. The question must then be asked: Is corporatisation of public utilities enough and if it is, why completely sell the enterprise to the private sector? The analysis of this question will be evident during the latter stages of this report.

Commercialisation is where a Government utility is encouraged to compete in the open market whereas previously it may have been heavily subsidised by the government to keep it competitive. Commercialisation and Deregulation (allowing the private sector to compete on equal terms with the public sector) are virtually inseparable means to an end - the end being a more competitive, efficient, and productive industry.

It can be seen then that privatisation may or may not be the ideal alternative to a particular government utility as it depends on many factors such as:

- . whether the utility is a natural monopoly
- . whether the utility already operates under a deregulated industry and is already competing with private enterprise.
- . how efficiently the public utility is already operating.
- . how much independent control the management already has over the operations of the public enterprise, and
- . the operating results of the public utility after eliminating any Government subsidies as compared to its private sector competition.

It may be found that for a particular public utility, that corporatisation of that utility under a deregulated market, may result in it being highly competitive in the competitive market place and result in a more effective solution than if it were fully privatised by selling it to the private sector.

These issues will be addressed to the situation of QANTAS Airways Ltd which it seems will be privatised in the not too distant future.

Privatisation of QANTAS Airways Limited

The analysis of QANTAS will take the following format:

- (a) the nature of QANTAS activities
- (b) the present market structure of the International Airline Industry and QANTAS's place in that market
- (c) an analysis of the recent performance of QANTAS and its efficiency of operations including its capital/debt structure, and
- (d) the future market prospects of QANTAS, possibly in a deregulated market.

(i) The Nature of QANTAS Activities

The principal activities of QANTAS Airways Limited are the operation of International Air Transportation Services, both passenger and cargo, and selling world wide package tours. Services are operated to 41 cities in 24 countries.²

The airline was purchased by the Australian Government in 1947 and the airline has been Australia's sole international carrier ever since.

(ii) Present Market Structure of the International Airline Industry and QANTAS's place in it.

The international airline industry is a highly competitive industry with most countries in the world operating at least one international airline and some countries such as the United States operating many and thus there are well over one hundred international airlines world wide.

Of course the industry is not so freely structured to allow any airline access to all countries. It is thus a highly regulated industry whereby landing rights by one country to another countries' airline(s) will usually depend on reciprocal arrangements in that other country.

The industry is characterised by '*Bilateral Air Services Agreements*' such as the Australian Government allowing Singapore Airlines landing rights in Australia as long as QANTAS is allowed equal landing rights in Singapore. Between Australia and the United States, there operates the Australia - USA Air Services Agreement, which controls QANTAS landing rights in the USA and certain US airline landing rights in Australia. *The agreements usually specify the routes allowed, the frequency of travel, the capacities allowed and the fares agreed to.*³

Of course there are some Unilateral agreements whereby QANTAS may be allowed to fly into certain smaller countries that do not have

their own international airline so as to provide a much needed service in the pacific area, for example. Some smaller international carriers may be allowed landing rights in Australia so Australia can earn much needed foreign exchange from tourism and where it is not economically feasible for QANTAS to operate to those countries such as in the remote pacific areas.

The international market structure of overseas air travel to and from Australia could thus be categorised as a partially regulated *Oligopoly* as there is direct competition by various airlines on the same routes, for example, QANTAS and Singapore Airlines on the Sydney to Singapore route.

If you look at QANTAS as an Australian international airline, it has a monopoly as far as Australian International operators are concerned - This is expected to change with the deregulation of the domestic airline industry on 30 October 1990, whereby the old '*two-airline policy*' that restricted large scale domestic operations to Ansett and Australian Airlines, will allow "*any operator satisfying the civil aviation authorities*" licensing criteria, which will be based solely on the operator's ability to meet safety standards, will be able to provide services between Australian airports."⁴ - the same opportunity is expected to arise for international operations. A new Australian airline called '*COMPAS International*' is expected to enter the deregulated industry after October 1990 firstly on domestic routes and possible later on international routes.

At present due to the characteristics of the industry and its regulation, there has been quite a deal of control over the setting of airfares. Airfares are not necessarily set according to cost criteria but set as part of the Air Services Agreement between particular countries. Each airline naturally is endeavouring to at least make a profit and then to maximise those profits and as some airline operations may mean that their costs of operations are much greater than others' on the same route then fares will tend to be set much higher than at the point where marginal cost equals marginal revenue. For example, Table 1, which has been produced from the various annual reports of a selection of airlines for 1987/88 shows that Singapore Airlines made a 14.29% profit on operations (before tax) whereas QANTAS made 4.96% profit. If these figures were to be much the same for the Sydney to Singapore route, the airfares negotiated by the Australia/Singapore Air Services Agreement would result in fares where QANTAS would be making a profit and at that point, profits for Singapore Airlines would be approximately 9.3% higher than if only Singapore Airlines' operated on the Sydney to Singapore route. In other words, passengers on this route are paying higher airfares because QANTAS's costs to operate on that route are much higher than Singapore Airlines. As it is difficult to obtain specific operating results for particular routes for various airlines, this claim cannot be specifically substantiated but it does appear that due to inefficiencies of some airlines, due to over-regulation and government control, that consumers may be paying much greater airfares than they would under a completely deregulated market or at least a partially deregulated market.

TABLE 1

COMPARATIVE FIGURES FOR AIRLINE OPERATIONS FOR THE YEAR 1987/88

(all figures are converted to \$A)

Operating Results	Airlines				
	QANTAS	Singapore Airlines	Lufthansa	British Airways	Australian Airlines
<u>Financial</u>					
Total Revenue	\$ 3084.7m	\$ 2638.7m	\$ 8226.0m	\$ 7594.0m	\$ 1088.6m
Total Expenditure	\$ 2931.4m	\$ 2261.5m	\$ 8058.6m	\$ 7133.1m	\$ 1022.0m
Profit (before tax)	\$ 153.3m	\$ 377.2m	\$ 167.4m	\$ 460.9m	\$ 66.6m
% Profit (B/T) to Total Revenue	4.96%	14.29%	2.03%	6.06%	6.1%
Current Ratio ¹	1.09:1	1.16:1	1.09:1	0.61:1	0.51:1
Debt Ratio ²	0.76	0.49	0.78	0.79	0.86
<u>Operations</u>					
Kilometers Flown	97.6m	97.3m	390m	n/a	n/a
% Profit per Kilometer	\$1.57/km	\$3.87/km	\$0.43/km	n/a	n/a
Passengers Carried	3,453,749	5,618,000	22,546,000	23,230,000	5,720,000
Revenue Load Factor	71%	74.8%	68.6%	67.3%	76.5%
Market Share - Inbound *	42.98%	6.46%	0.90%	4.36%	n/a
- Outbound *	42.89%	6.45%	0.83%	4.26%	n/a
<u>Personnel</u>					
Average Number of Employees	14,780	16,063	49,056	42,709	9,661
Total Employee Costs	\$ 615.6m	\$ 470m	\$ 2,725m	\$ 1,755m	n/a
% Employee Costs to T/Revenue	19.9%	17.8%	33.1%	23.1%	n/a

Table 1 continued

Airlines		QANTAS	Singapore Airlines	Lufthansa	British Airways	Australian Airlines
Operating Results						
<u>Assets</u>						
Current Assets		\$ 1,147.0m	\$ 1,628.8m	\$ 1,792.5m	\$ 1,821.7m	\$ 226.5m
non-Current Assets		1,627.7m	2,520.8m	5,437.5m	4,458.1m	1,331.3m
TOTAL ASSETS		<u>\$2,774.7m</u>	<u>\$4,149.6m</u>	<u>\$7,230.0m</u>	<u>\$6,279.8m</u>	<u>\$1,557.8m</u>
<u>Liabilities</u>						
Current Liabilities		1,045.8	1,397.9m	1,638.1m	2,974.1m	442.8m
Non-Current Liabilities		1,066.4	641.7m	4,010.9m	2,023.8m	897.3m
TOTAL LIABILITIES		<u>\$2,112.2m</u>	<u>\$2,039.6m</u>	<u>\$5,649.0m</u>	<u>\$4,997.9m</u>	<u>\$1,340.1m</u>
SHAREHOLDERS EQUITY		<u>\$662.5m</u>	<u>\$2,110.0m</u>	<u>\$1,581.0m</u>	<u>\$1,281.9m</u>	<u>\$217.7m</u>

ADDITIONAL INFORMATION:

1. Exchange rates used for conversion purposes were from the Australian newspaper, 2 November 1989.

\$1A = 1.44 dm

\$1A = \$1.52 s

\$1A = 0.4946 U.K.pnd

2. * Market share percentages were obtained from the 'Department of Transport and Communications for International Travellers - year ended June 1988'.

3. 1 Ratio of current assets to current liabilities.

4. 2 Ratio of total liabilities to total assets.

(iii) Analysis of Recent performance of QANTAS and its efficiency of operations including Capital/Debt Structure

The following data was obtained from the Annual Report of QANTAS for 1987-1988 in relation to its Profits (losses) on operations for the ten (10) year period 1979 to 1988 and the percentage changes each year have been extrapolated.

TABLE 2 QANTAS OPERATIONS - 1979 TO 1988

Year	Profit (Losses) on Operations	% Change	% Profit (Loss) to Revenue	Revenue Load Factors
	\$			
1988	153.3m	46.9%	4.96%	71%
1987	104.3m	134.9%	4.07%	68%
1986	44.4 m	(29.1)%	2.2%	65%
1985	62.7 m	7.5%	3.8%	65.6%
1984	58.3 m	222.9%	4.06%	61.5%
1983	(47.4)m	(134.6)%	(3.5)%	59.5%
1982	(20.2)m	45%	(1.7)%	62.7%
1981	(37.1)m	(430)%	(3.5)%	62.2%
1980	(7.0)m	(128)%	(0.7)%	65.4%
1979	25 m	-	3.2%	61.3%

As can be seen from Table 2, QANTAS had made consistent losses for the period 1980 to 1983 and then there was a massive 222.9% increase to 1984 to result in profits up to the present time. Unaudited Profit and Loss Statement for the year ended 1989 indicates Profit on operations of \$177.2 m which is a 15.6% increase on the previous year and profit on operations as a percentage of Revenue is 5.41%. So it appears that QANTAS has gradually, over the last 5-6 years, become more profitable but the percentage increases have been quite erratic as from 1986-1987 there was a 134.9% increase in profit, then for 1987-1988 only a 46.9% increase and now for 1988-1989 only a 15.6% increase. Many factors may be causing this, such as loss of market share to other airlines, a general downturn in overseas travel, increased operating costs of the airline due to higher wage claims, or many other factors. It is beyond the scope of this report to investigate these, however as a comparison, if you were to look at the past 10 years operating results of Singapore Airlines from their 1988-89 Annual Report, they have consistently achieved profits at an increasing rate since 1979-80. Naturally it is difficult to compare airline results as they are all operating on

different routes, (some parallel), under different cost/wage structures and so on, however the fact that the majority of Singapore Airlines is privately owned [Temasek Holdings (private) Limited has 55.79% ownership],⁵ with consistent profits and QANTAS is completely Government owned with a combination of losses followed by profits at an inconsistent rate of change, this gives the impression that private ownership of international airlines in itself may lead to a far more efficient airline, efficient airline industry and if deregulation were present, far more discounting of airfares to the travelling public.

In order to try and expand on this hypothesis, Table 1 has been prepared from information from the annual reports for the year 1987/88 for QANTAS, Singapore Airlines, Lufthansa, British Airways and Australian Airlines. These airlines were chosen so as to give a comparison of European Airline operating results with those of the Australasian region's airlines. Australian Airlines, which operates solely in the domestic Australian market was included in the chart for comparative purposes of its operating results as against QANTAS's results, as they are both Australian Government owned and there is a suggestion in the media at present that both may be merged into one privatised company, however detailed analysis of the implications of this are beyond the scope of this report.

(iv) Analysis of Data

As can be seen from the Data, QANTAS's total Revenue was \$3,084.7m which as compared to the European Airlines appears less than half but for the routes QANTAS services around the world, it is probably quite good - Lufthansa and British Airways operate all over Europe where there is a potential market of 330 million people whereas QANTAS only flies to 6 destinations in Europe.

Profit (before tax)

Obviously a major indicator of any airlines efficiency is the profits (losses) it is making and the percentage of that to total Revenue. QANTAS produced a profit of \$153m for 1987/88 (\$177m-1988/89) which is 4.96% of total revenue. This percentage is quite low however it is the highest percentage QANTAS has achieved in the past ten years. As a comparison, Singapore Airlines achieved an equivalent \$A profit of \$377.2m or 14.29% of Sales which is quite high compared to the other airlines in this comparison. It should be noted however that Singapore Airlines up to 1984-85 turned in less than 5% net profit results and thus it is only over the last four years that their results have improved so dramatically.

Lufthansa's results on the otherhand seem to be very low: \$167.4m or 2.03% of Sales (the profit would have been lower if the actual \$A to dm exchange rate in 1987/88 had been used in the table). This may be due to many factors beyond the scope of this report.

British Airways produced a \$460.9m profit or 6.06% of turnover which appears to be a respectable result. In 1986/87, British Airways was privatised by the Thatcher Government. To see if any correlation can be observed between pre-privatisation and post privatisation, the following table has been produced from information in the British Airways 1988/89 Annual Report.

TABLE 3

British Airways Results - 1988/89 Annual Report

Year	Turnover m	% increase	Operating Surplus	% increase
88/89	4,257m	13.3%	336	42.3%
87/88	3,756	15.1%	236	36.4%
86/87	3,263	3.62%	173	(12.6)%
85/86	3,149	6.9%	198	(32)%
84/85	2,943	-	292	-

It does appear from the data in Table 3 that there has been a quite dramatic change in the turnover and operating surplus of British Airways post-privatisation (1986/87). Surpluses had been decreasing from 1984/85 to 86/87 and then a dramatic 36.4% increase to 1987/88 and a 42.3% increase for 1988/89. This has been achieved with only marginal increases in turnover - 15.1% for 1987/88, and 13.3% for 1988/89 which indicates that the extra profits have been achieved by reducing costs possibly mainly in the area of employee wage costs by rationalising the company into more productive divisions with a minimum of management control so as to minimise managerial costs. Once again, to prove this, could be the subject of another report.

The profit result of Australian Airlines in comparison to the international carriers appears to be quite acceptable at 6.1% of Revenue, however, a real comparison would need to be done comparing Ansett Airlines and Australian Airlines results.

Current Ratio Data

The current ratio of QANTAS at 1.09:1 is quite acceptable and as long as it stays above 1.00:1 this is an acceptable level so as to meet the current liquidity requirements of operations. Of the other airlines in Table 1, only British Airways and Australian Airlines have undesirable situations. If it is due to short term capital expansion it may not present a longer term problem to the airline, if it can generate increased revenues in the future.

Debt Ratio Data

The debt ratio's indicate that QANTAS has 76% of its total assets required to meet total liability commitments in the future which is quite a high figure, however quite a percentage of the total liabilities are for Trade creditors which are secured by charges on certain Boeing aircraft. There is also \$427.6m included as other liabilities being for revenue received in advance from future travelling passengers. So the debt ratio is probably not as bad as it appears.

Singapore Airlines has a very good ratio approaching 50%. Lufthansa's ratio is not very desirable at 78% as well as for British Airways 79% and

Australian Airlines 86%. Once again these liabilities tend to be secured over aircraft assets and do not present a major problem.

Operating Data

The percentage profit per kilometre figures tend to reinforce the view that Singapore Airlines profitability as compared to the total kilometres flown is the highest in this group of airlines and tends to correlate with its overall results.

Singapore Airlines' profit per kilometre, is more than double that of QANTAS even though both airlines very nearly travelled the equivalent number of total kilometres. Lufthansa returned only \$0.43/km which is quite low compared to the other two and may reflect the much greater frequency of landings in Europe and its associated costs or it may be caused by other unknown factors. There were no figures available for the other two airlines.

Revenue Load Factors

The Revenue Load Factors are an indication of the percentage of total available capacity actually utilised for the carriage of paid traffic. As the figures indicate, QANTAS at 71% appears to be an acceptable level as compared to the industry. Singapore Airlines once again has the highest at 74.8% for the international carriers. Australian Airlines appears to do quite well at 76.5% on the domestic routes.

Lufthansa and British Airways figures are also quite good overall. Of course these figures are the average of all routes travelled and on some routes, for example, Sydney to Frankfurt, you may find that Revenue load factors for both Lufthansa and QANTAS may be up in the vicinity of +90% especially around the Christmas period, so to really compare revenue load factors between airlines, a comparison of specific routes at particular times of the year would need to be done which is naturally outside the scope of this report.

TABLE 4

INTERNATIONAL PASSENGERS YEAR ENDED JUNE 1988

AIRLINE	Inbound	Market Share	Outbound	Market Share
AIR CALEDONIE	11881	0.32%	11576	0.33%
AIR INDIA	26583	0.72%	28513	0.81%
AIR NAURU	1347	0.04%	1808	0.05%
AIR NEW ZEALAND	420427	11.44%	410412	11.73%
AIR N IUGINI	34109	0.93%	31284	0.89%
AIR PACIFIC	66266	1.80%	64650	1.85%
AIR VANUATU	1896	0.05%	1910	0.05%
ALITALIA	34906	0.95%	32732	0.94%
ALL NIPPON AIRWAYS	11909	0.32%	11960	0.34%
BRITISH AIRWAYS	160296	4.36%	148961	4.26%
CAAC	10133	0.28%	9289	0.27%
CANADIAN AIRLINES INTL	22594	0.61%	20288	0.58%
CATHAY APCIFIC AIRWAYS	154088	4.19%	135993	3.89%
CONTINENTAL AIRLINES	201936	5.49%	199329	5.70%
COOK ISL INTERNATIONAL	1648	0.04%	1722	0.05%
GARUDA INDONESIA	109320	2.97%	103008	2.94%
HAWAIIAN	3117	0.08%	3113	0.09%
JAPAN AIR LINES	107328	2.92%	99907	2.85%
KLM ROYAL DUTCH A/L	16115	0.44%	14070	0.40%
LAUDA AIR	335	0.01%	609	0.02%
LUFTHANSA GERMAN AIRLINES	32992	0.90%	29075	0.83%
MALAYSIAN AIRLINE SYSTEM	78591	2.14%	72969	2.08%
MERPATI NUSANTARA A/L	3389	0.09%	3914	0.11%
OLYMPIC AIRWAYS	36782	1.00%	32674	0.93%
PHILIPPINE AIRLINES	49212	1.34%	43641	1.25%
POLYNESIAN AIRLINES	3023	0.08%	2595	0.07%
QANTAS AIRWAYS	1579671	42.98%	1501179	42.89%
ROYAL BRUNEI A/L	6491	0.18%	6028	0.17%
SINGAPORE AIRLINES	237345	6.46%	225846	6.45%
SOLOMON ISLANDS A/L	0	0.00%	0	0.00%
SOUTH AFRICAN AIRWAYS	4567	0.12%	4164	0.12%
THAI AIRWAY INTL	69552	1.89%	76445	2.18%
UNITED AIRLINES	132390	3.60%	128087	3.66%
UNION de TRANSPORTS AERIENS	19716	0.54%	19168	0.55%
YUGOSLAV AIRLINES	25086	0.68%	22849	0.65%
TOTAL	3675041	100.00%	3499768	100.00%

Ref. Dept. of Transport & communications.

Market Share Data

The market share figures in Table 1 only relate to air traffic in and out of Australia and not share of the world air traffic market. Naturally, as can be seen, QANTAS has the majority share at close to 43% for both inbound and outbound traffic for the year ended 30 June 1988. Air New Zealand has the next largest share at around 11.5% as per Table 4 data, Singapore Airlines has the third highest share at only approximately 6.5%. Continental Airlines from America has approximately 5.5%. British Airways has approximately 4.3% and for all other airlines, the market share is progressively reduced. Lufthansa has only approximately a .8% share.

This may indicate that certain international airlines may be restricted in their access to Australian Airports as negotiated in their air services agreements with Australia and restrictions placed on QANTAS flying to certain countries on route to Europe and other destinations. So it certainly seems that access to the Australian market is quite regulated by the Australian Government in conjunction with the Civil Aviation Authority and the Bureau of Air Safety. Deregulation of the international airline industry would possibly see many changes to the market shares into and out of Australia. A more detailed discussion of this will follow later in this report.

Personnel Data

Looking at the Personnel data in Table 1, it can be seen that the number of QANTAS employees in total does not appear to be excessive when compared to Singapore Airlines which flies a similar number of kilometres however the number of employees required to operate an international airline efficiently depends on many factors such as:

- . the productivity per employee
- . the various categories of employees employed, such as flight crew, catering staff, aircraft maintenance staff, administration staff and the percentage of each category to the total staff numbers,
- . the total employee costs and costs per category.

Some of this data is difficult to obtain, however in Table 1 it can be seen that total employee costs for QANTAS as a percentage of total revenue was 19.9% whereas for Singapore Airlines (SA) it was 17.8%. This may indicate that even though SA uses more employees for its similar service to QANTAS, their wages may be lower overall and thus greater profits are earned per employee than by QANTAS.

From discussion with the Passenger Marketing Manager of Singapore Airlines (Australia), it would appear that SA pilots fly quite a deal more hours than their Australian counterparts and thus productivity overall is higher and airline costs lower, which naturally relates to higher profits overall.

It can be seen that Lufthansa is a very large airline with approximately 49,000 employees and its total employee costs as a percent of total revenue is quite high at 33.1% if compared to the other airlines in Table 1, but if compared to the average employee costs of a business in Australia, it is quite normal. The British Airways figure of 23.1% is higher than for QANTAS or SA but this is possibly due to operating many more flights in

Europe where shorter stopovers require more frequent changes of cabin crew and thus employee costs increase.

The assets and liabilities of the various airlines in Table 1 have been examined under the current and debt ratio analyses previously stated.

Shareholders Equity

The various ownership of shares for each of the five airlines shown in Table 1 are as follows in relation to private and public shareholdings as at 30 June 1988.

TABLE 5

Ownership of Airlines - June 1988

	Public (Govt)	Private
QANTAS	100%	-
Singapore Airlines	-	100%
Lufthansa *	65.38	34.62%
British Airways	-	100%
Australian Airlines	100%	-

(Data from Annual Reports - year ended June 1988)

Note that due to a new share issue by Lufthansa during 1989 to the public, the *"Federal Republic of Germany's ownership will slip to approximately 52%"*.⁶

There is a great deal of variation in the ownership of the various airlines and based on the evidence to date it would appear that private ownership of Singapore Airlines has resulted in a very efficient airline and as previously analysed, it has improved greatly the results for British Airways since Privatisation in 1986/87. Then again, QANTAS's operating results in the past five years have been respectable in the industry and this is probably due more to the Corporatisation of QANTAS by the Australian Labor Government since 1983 so as to ensure the airline performs more as a private enterprise company in the still quite regulated market.

So there appears to be more of a correlation between efficiency of operations and management style than with whether the airline is private or publicly owned. This is born out by the case of Lufthansa which is approximately 65% public and 35% privately owned and its results as far as efficiency criteria, seem to point to a less efficient airline than either QANTAS or Singapore Airlines, which are at both ends of the ownership scale.

Future Market Prospects of QANTAS

The future of QANTAS Airways Limited depends largely on maintaining a sustainable competitive advantage against all the other international carriers and to maintain its existing market shares and try to increase those shares over time. To remain competitive will probably require QANTAS to be continually looking at ways to reduce their operating costs especially employee costs and aircraft operating costs (without compromising safety standards), and to try and increase passenger numbers on these aircraft by aggressive marketing campaigns so as to give the flying public what they want in their service.

Other factors that will affect the future operations of QANTAS are whether it can maintain industrial harmony within the airline as a similar '*Pilots Dispute*', as occurred in the latter part of 1989 in the domestic aviation industry, if it occurred in QANTAS, may spell disaster for the airline, as no doubt market share would be lost to Singapore Airlines and to many other larger airlines flying into Australia. This type of situation may be averted by more '*employee bonus schemes*' for increased productivity, greater management - employee consultations on wage claims and if QANTAS were fully privatised, the availability of shares in QANTAS to be purchased by employees. This has been a major factor in the success of Singapore Airlines where employees are encouraged to purchase shares and feel '*part of the company*' and also with the improvement in '*British Airways*' industrial relations with employees.

This employee factor could very well be the major consideration in deciding whether privatisation of QANTAS is a desirable prospect in the future. It is one thing to corporatise a government entity and make it more efficient but it is an entirely different situation if the entity is privatised and employees encouraged to become shareholders of the new company. The feeling of '*identity*' with the success of the company by employees, may well prove that privatisation could lead to a much more competitive airline.

Effects of Deregulation

The future prospects for QANTAS also largely depend on whether the Australian Government decides to deregulate the domestic and international airline industry in Australia. Domestic deregulation will go ahead from 30 October 1990 when the two-airline policy will cease operating and more new Australian operators will be allowed access to the domestic market in competition with Ansett Airlines, Australian Airlines and East-West Airlines. It is expected that airfares will reduce to some extent which, at this stage, it is not known by how much as only market forces will dictate this. However if domestic airlines are lower, this may encourage more tourists from overseas to Australia and thus the market for the international airlines will increase.

It is also envisaged that international carriers will be allowed more, but still restricted, access to the domestic Australian market under deregulation of the domestic market whereas domestic airlines will be "*denied access to operate international services*".⁷ It remains to be seen what effect this may have to the airline industry.

Deregulation in Australia will not be total deregulation as the "*industry will be subject to the jurisdiction of the Prices Surveillance Authority and the Trade Practices Commission*"⁸ as well as the Civil Aviation Authorities' - Safety Standards Committee.

It is doubtful that a total deregulation of the International Airline's access to Australian Airports will be allowed as virtually all countries will still negotiate landing rights through the Air Services Agreements as to such factors of flight frequency, capacity restrictions, fare structures, air safety and so on.

There is a natural limitation on the number of flights allowed into a country by the ability of air traffic controllers to control this at certain times in certain cities, and other factors such as the size of airport runways and facilities and thus there will always be quite a deal of control over the international carriers access to Australia. The same situation arises for access of QANTAS to overseas airports and once again this access would be subject to negotiation between the various Governments and the airlines themselves.

One important point that should be made is that if Australian Tourism-inbound continues to increase the way it has been in the last five years, the Australian Government should ensure that the facilities and infrastructure is set up well in advance to cater for this valuable market and if QANTAS could not meet the demand, other international carriers and possibly a new Australian carrier should be encouraged to enter the market. Australia's tourism market should not be restricted just to protect the interests of the Government owned QANTAS Airways Limited. Competition is vital to a healthy future in the International Airline industry.

*"Tourism's total turnover, including domestic and international spending, was about \$20 billion in 1988-89, making it a large contributor to improving Australia's Balance of Payments"*⁹ - current account deficit problems. The industry must be structured so as to best serve the touring public and not what is just apparently in the best interest of a particular international carrier whether Australian owned or Overseas owned.

POLITICAL CONSIDERATIONS

The case of whether QANTAS should be privatised or not and what form it should take if it does is not just a question of economics but also a major political, social and cultural question.

As far as politics is concerned, a quote in the Australian Newspaper on Monday September 18, 1989 is relevant: The Headline stated *"Airline privatisation push abandoned"*. In the body of the article it stated:

"Labor Party policy requires that both airlines (QANTAS and Australian) be kept in full government ownership and control". "Mr Willis and the Prime Minister and other key cabinet ministers have publicly supported privatisation". "Mr Willis, is expected to propose a complicated issue of non-voting preference shares that will meet the airline's capital requirements but keep them under full government ownership and control". "Mr Willis confirmed that a recent meeting involving himself, the Prime Minister, and the Treasurer, Mr Keating, had ruled out a merger between QANTAS and Australian Airlines".¹⁰

Naturally these political considerations have a great deal of impact on the privatisation issue and will be discussed further, later in this report.

ARGUMENTS FOR PRIVATISATION OF QANTAS

One of the major arguments given for privatisation is that, at present, QANTAS has a virtual monopoly as an Australian International Airline and because there is tight Government regulation on which international airlines are allowed to operate into and out of Australia, as well as tight control or regulation on the setting of passenger fares, all this tends to lead to a less than optimum 'allocative' and 'productive' efficiency levels of operations for QANTAS. Allocative efficiency refers to where goods and services are produced that the consumers want the most of and productive efficiency is where unit costs of production are minimised.

With full or part privatisation of QANTAS, or even more efficient 'corporatisation' of QANTAS, the suggestion is that due to trying to maximise the efficiency of operating QANTAS by minimising costs and maximising revenues, then in a more deregulated, competitive market in the future, QANTAS should be able to compete well in the market place for International travel and certainly better compete than if it were not privatised.

More competition in a less regulated market would also require QANTAS to use the latest technology not only in relation to aircraft but in communications networks and marketing techniques so as to keep its unit costs to a minimum and be highly competitive in the market place. This is termed the *X-inefficiency* factor which is normally associated with Government run monopolies. The more efficient QANTAS can become the more competitive it can become and thus airfares may be able to be reduced which would hopefully increase sales and market share for QANTAS in the future.

It appears from a previous analysis that Singapore Airlines, which is a major competitor of QANTAS has used these techniques greatly to their advantage in the past ten years and private ownership appears to have resulted in a very efficient airline. Privatisation may have the advantage of boosting staff morale in QANTAS by encouraging ownership of shares in QANTAS by the staff and they would receive dividends for increased profits by QANTAS. This would give a sense of *identity* with the airline and maximise staff incentive to give the best service available and try and be always that much better than the competition. The use of employee bonus schemes for productivity increase greater than a minimum level, as Singapore Airlines employs, would also boost QANTAS staff morale. It would be much harder to achieve this sense of *identity* with QANTAS if it remained a Government owned airline.

When considering Privatisation of any Government owned entity it is important to see if the entity is considered to be in a natural monopoly industry or a competitive industry. QANTAS would tend to be in the competitive sector as its main competition are many of the privately owned and to a lesser extent, public owned overseas airlines.

Naturally, if many of the previously publicly owned overseas international airlines are in the process of being either part or fully privatised (such as British Airways), then if Australia is to compete in the future with these, probably, increasingly efficient airlines, then QANTAS may have little choice but to Privatised in order to compete or risk going into liquidation. As has been noted earlier, Singapore Airlines' operations appear to be more efficient than QANTAS's operations and if the market were deregulated more in the future, due to Singapore Airlines lower operating costs, it would

probably be able to undercut QANTAS airfares (if Government control allowed this) and increase its market share on the Australia-Singapore-Europe routes. The same may apply if Thai Airways, Cathay Pacific, and other Asian Airlines' were allowed more frequent, increased capacity flights to Australia with more access to domestic destinations than at present. It remains to be seen whether privatisation of QANTAS and more deregulation of the industry does lead to reduced airfares.

At present, QANTAS must obtain ministerial approval for large capital expansion programs which is time consuming and inefficient. Under privatisation, direct consultation with banks would ensure more timely decisions. The Chairman of QANTAS, Mr Jim Leslie stated in an interview with the Sydney Morning Herald, April 28, 1988 that *"....the airline should be sold to the private sector. This should lead to cheaper fares through increased efficiency. There are serious inefficiencies in Government ownership that are impossible to avoid. The real inefficiencies originated in the cost of equity capital. A private company could raise equity capital during profitable periods by issuing new shares. The greatest efficiency in capital raising arose from timing the issue to meet the company's and the shareholders' best interests. A government-owned company was always subject to pressures which made it virtually impossible for the board to make quick major strategy decisions on a purely commercial basis. I challenge anyone who suggests that Government ownership of a company involves more advantages than disadvantages."*¹¹

Privatisation it is suggested may increase efficiency, accountability, responsibility, reward, incentive and management freedom. One other suggested benefit of Privatisation of government enterprises in general was stated by Lawrence Burr, National Director, Financial Services of Ernst and Whinney at a seminar given to the Australian Society of Accountants that the Government should establish a capital fund from the proceeds of privatisation which can be used for investment *"to develop tomorrow's industries for tomorrow's Australians". It is appropriate for the Australian Government to lead in the development of major new industries which have significant infrastructure requirements and where the risk factors make private capital sources hesitant to support them such as the development of an Australian Space Industry*".¹² These suggestions may be valid advantages as an offshoot to privatisation of QANTAS.

ARGUMENTS AGAINST PRIVATISATION OF QANTAS

The main argument against privatisation would be if QANTAS was completely sold off to the private sector and the shares were bought by only a few number of large wealthy shareholders as well as there being no real deregulation of the international airline industry, then it would appear that a government monopoly is just being transferred into a private monopoly with the same issues of whether it would maximise its *allocative* and *productive* efficiency. (X-inefficiency factors may still apply). If this did happen, naturally there may be little benefit to the consumers of the services of QANTAS than what is already on offer. The main difference though would be that previously any profits go into consolidated revenue in the public sector to the benefit of all Australians, but under this form of privatisation, the profits would go to a few members of society as well as the dividends and other benefits.

In relation to Singapore Airlines, *"55.68% of the shares at 31 March 1989 were held by Tamosek Holdings (Private) Limited and the majority of the rest by nineteen other private banks and private companies. Twenty shareholders held 87.17% of the total shareholders Equity". (Annual Report 1988-89)*

Obviously in the case of Singapore Airlines', it started operations as a Private company and possibly its success in a short period of time has been due to this private ownership, however, it is difficult to say what benefit this has had to the Singapore public as a whole but it certainly has benefited consumers by keeping airfares at a competitive level and service up to a very high level.

In relation to QANTAS, it may not be in the best interests of the Australian public if its ownership was as intensely owned by few shareholders as with Singapore Airlines as far as '*public perception*' is concerned and its '*image*' after Privatisation.

There is a threat, that if QANTAS were privatised how is it going to compete in a less regulated market against the Asian/Oriental Airlines such as Singapore, Thai, Malaysian, Korean, Cathay Pacific Airlines which fly often the same routes as QANTAS but their wage costs tend to be marginally less than QANTAS?

Earlier it was stated that only for the fact of the Air Services agreement between the Singapore Government and the Australian Government in relation to setting of airfares, that because Singapore Airlines profitability is better than that of QANTAS, it may have lowered its airfares on routes to Australia by now, naturally to the benefit of the travelling public. If this did happen, naturally QANTAS may lose quite a deal of its market share to the Asian/Oriental Airlines, and the Asia/Pacific region is after all the main revenue routes for QANTAS on its way to Europe and the United States. QANTAS operating costs, especially wages would need to be streamlined quite a deal to be able to also lower its airfares in line with the Asian carriers so as to still achieve a profitable outcome in the future.

Once again, the intervention of the Australian and other Governments through their Air Services Agreement may still be required to ensure the profitability of any Australian International Airlines by the setting of airfares at a realistic level so all efficient carriers can maintain a reasonable profit level of operations otherwise QANTAS may end up uncompetitive and cease to operate in the years to come.

The travelling public want to have cheaper airfares available but at what stage are they prepared to accept that their Australian International Airline may cease to exist because of this. Probably most people would tolerate competitive airfares based on a reasonable profit margin and airline differentiation mainly in non-monetary benefits, such as better service and facilities, more promotions such as chances to win free trips to certain destinations, and the best air safety requirements available.

One other problem that may arise is that due to the major costs involved in establishing an international airline, there are substantial barriers to new competition and we may expect that very few new carriers enter the market in the next few years even after the market is partially deregulated.

This may give rise to an oligopolistic situation that is more intense than it is at the present time, and thus airfare regulation via Collusive Agreements (unless outlawed by the Government) may lead to a less efficient industry and higher airfares. This situation however is unlikely to arise due to the intense competition between airlines and the various Air Services Agreements under a more deregulated market would ensure that this does not happen via Government intervention and control.

There is a perception by some members of the public that Privatisation of QANTAS may lead to a greater threat of air disasters because of private companies trying to minimise costs to increase profits, such as on maintenance of aircraft. It has been seen in the US situation that since deregulation in 1978, there was quite an increase in the number of air crashes, which may be due in part to increased air traffic, but could also be due to less stringent air safety requirements.

QANTAS has one of the best safety records of any of the International Airlines at present and Australian air safety is also very strictly enforced by the Bureau of Air safety and the Civil Aviation Authority (C.A.A.). As long as these bodies continually enforce their strict guidelines after privatisation of QANTAS and a less regulated international air system, then this should present no major problems in the future. Naturally the frequency of air traffic will increase in the future due to many reasons such as increased tourism, and so it will be up to Air Traffic Controllers to ensure that Safety is of the utmost consideration to each individual airport and airspace around Australia in general.

RECOMMENDED FORM OF PRIVATISATION

The most logical form of privatisation of QANTAS could be a public issue of shares on the Australian Stock Exchange. Current estimates are that QANTAS as a going concern is worth about \$1 billion (Financial Review, Friday, September 8, 1989).

Staff of QANTAS should be encouraged to purchase shares so as to feel a part of and identify with the new company. This has tended to boost morale and efficiency of operations as the British Airways experience has shown. Foreign ownership of shares may need to be restricted as per the requirements of the Australian Government.

In the next few years, QANTAS is going to need a great capital expansion exercise in the form of new aircraft and other equipment and facilities so as to adequately compete under a more deregulated, less protectionist market. This could be accommodated by new share issues to the public as required.

Naturally, if full privatisation of QANTAS does go ahead there will be a transition period from the public sector to the private sector and it could be expected that this period could easily amount to the first year of operations. There would need to be evaluations on the requirements for the new management team and the staff required to service the new airline system. There maybe a rationalisation of staff numbers required with the possibility of some staff being allocated new responsibilities and some excess staff being laid off.

This initial period will be important to the public's perceptions on the benefits of the eventual privatisation of QANTAS. If there is a massive standdown of staff just after the new ownership, this may affect the future market of QANTAS if the public believes this was too heavy-handed an approach by the new management. Thus it is important that the rationalisation process is done gradually throughout the transition period so as to have the best results to QANTAS in the long run.

It would be in the best interests of the new company to retain the most important Top management especially in the transition stage so that there is the least possible disruption caused to the normal operations of QANTAS during the transition period.

The Australian government, in the interests of the long-term future of QANTAS, should give QANTAS as much technical and managerial assistance during the transition period, after privatisation, as possible.

ALTERNATIVES TO PRIVATISATION

The only real alternative to privatising QANTAS would be for the Australian Government to continually try to operate QANTAS as a business by ensuring its efficiency continually increases by reducing costs and trying to increase revenues by aggressive marketing and advertising campaigns so as to be as competitive as possible in the future. This may be achieved to some extent, by contracting the services of independent management consultants, such as one of the larger Chartered Accountancy firms, to produce a detailed '*Efficiency Report and Recommendations*' for the future viability of QANTAS. In this way, QANTAS's strengths could be enhanced and its weaknesses minimised or eliminated.

If this is not done, QANTAS may find it cannot compete in the future with other overseas airlines and may have trouble continuing operations. This naturally would cause a great loss of revenue to the Australian Economy in the future and must be avoided at all costs. Full privatisation appears to be the best alternative.

FUTURE IMPACT OF PRIVATISATION ON THE OPERATIONS OF QANTAS

Privatisation of QANTAS should result in:

- (i) Generally a much more efficient, internationally competitive airline.
- (ii) QANTAS being able to possibly reduce airfares, or at least hold back on any fare increases so as to compete more aggressively on price with its competition, especially where the competition may be able to cut costs due to lower wage structures.
- (iii) Retention of *QANTAS* as an Australian International airline and the identity around the world that goes with that in relation to air safety, quality of service and so on.
- (iv) Boosting of staff morale with its connotations to better service etc, through the use of employee '*Productivity Bonus Schemes*' and share ownership by staff.
- (v) Increased profitability by increasing revenues through increased market share and reduced costs by rationalisation of requirements of staff numbers.
- (vi) Maintaining the excellent air safety record of QANTAS around the world by making this a top priority under the new management through regular maintenance programs and staff training schemes.

Of course all these results must be planned to happen and it would be up to the new management to ensure they did happen after privatisation. There would also be a great deal of *public perception* that these advantages should result and that if airfares did reduce or at least not increase in the short term, the travelling public obviously would benefit from privatisation of QANTAS and obviously the more travelling public QANTAS can sell air tickets to, the more profitable QANTAS will become.

LONG-TERM EFFECTS ON THE AIRLINE INDUSTRY

Obviously both the domestic and international airline industries are going through a period of great change after deregulation of the domestic market on 31 October, 1990 and it may result in the '*survival of the fittest*' as far as the next five to ten years in the industry is concerned especially with increased competition from overseas airlines trying to increase their market shares.

Free enterprise and the travelling public will be the ultimate winners due to privatisation of QANTAS and partial deregulation of the international airline industry and the airlines that have remained competitive will also be the winners. Which ones these will be, remains to be seen.

CONCLUSION AND POLICY RECOMMENDATIONS

From the limited evidence gathered and analysed in relation to this whole issue of whether QANTAS should be privatised, it is my opinion that despite the fact it is probably inevitable in the longer term, QANTAS should be fully privatised as soon as possible as long as there is also a partial deregulation of the International Airline Industry as far as Australian Air Services Agreements are concerned, so that healthy competition can result with the possibility of reduced overseas airfares to the travelling public. The Australian Government is trying to encourage Tourism into Australia and lower airfares with a depreciated Australian dollar should certainly help in that regard.

Control should still be exercised by the Australian Government through the Trade Practices Commission and the Price Surveillance Authority, so that oligopolistic situations in the airline industry in future don't restrict healthy competition through collusive fare setting by international carriers.

One thing is for certain; QANTAS will have the latest aircraft available in their new fleet of Boeing 747-400's of which they have already received one and they have '*ten on order*',¹³ and this will ensure it will remain competitive in the future and from all accounts, a bright future at that.

As a recent newspaper article stated '*IATA... expects an overall increase in traffic of 7 per cent next year (1990). The biggest growth is in Asia. Airlines such as British Airways were planning to capitalise on this by using the new long-range Boeing 747-400 to enable them to fly non stop to almost any destination in the world from London. The airline has 19 of the jets on order, of which four have been delivered*'.¹⁴

This form of competition from the private sector will ensure QANTAS must remain highly competitive in the future to the benefit of the airline industry as a whole, and the travelling public.

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Editors Note: This is an invited publication. The author, a student in UCCQ's Master of Business Administration Program, submitted this case study as part of the assessment in the subject Australian Business: Current Issues (Lecturer in charge: Liam Ryan).

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