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Airline ownership and control and the Single African Air Transport Market Agenda

(Presented by African Airline Association - AFRAA)

EXECUTIVE SUMMARY

This paper examines Airline ownership and control rules in Africa and their impact on the implementation of Single African Air Transport market (SAATM)

Over the past two decades, liberalization, privatization and globalization have significantly changed the airline industry worldwide.

Most of the Bilateral Air Service Agreements (BASAs) inspired by the Chicago Convention (1944) require a designated Airline to be **"substantially owned and effectively controlled"** by the designating State.

In the context of liberalization, Airlines need to levy more equity so that to sustain their growth. It becomes a challenge to source funds only on domestic financial markets with ownership restrictions.

1. Why ownership and control restrictions?

Airline industry is regarded in many States as essential to the national interest and sovereignty. They believe that domestic owners are more likely, than foreign owners, to preserve the national interest.

In many countries, the difficulty to find local equity funding of Airlines has resulted to having State owned Airlines.

De facto, ownership carries control rights of these Airlines by the governments. Recently, Airline bankruptcies and financial distresses are forcing these owner governments to subsidize these Airlines with huge amounts of money. They want to reduce their financial commitments to these national carriers.

Most of these governments are trying to attract foreign equity investors not exceeding 49% in their Airlines in an attempt to continue to keep the control. Keeping 51% means that they are reluctant to loose control on these Airlines.

2. What is the difference between ownership and control?

Ownership is relatively easy to establish, but effective control is more difficult. The concept of ownership of an undertaking is based on the notion of the equity capital shares.

Owners may differ with respect to their willingness and capacity to exercise effective control on an Airline. Obviously, a private investor holding 15% and an airline holding 15% of another airline have different willingness and capacity for the control this Airline.

Control may not be in direct proportion to ownership if conditions included in certain agreements or contracts confer a decisive influence to a shareholder.

A holistic assessment is needed to understand who is controlling an Airline:

- **Management Structure** – Entitlement to appoint to Directors and to Senior Management positions;
- **Key Legal documents** - Articles of Association/Shareholders Agreement providing specific rights on matters normally within the powers of the Board;
- **Aircraft Lease Agreements** – specific powers given to a shareholder to negotiate an conclude lease agreements;
- **Business Plan** – specific rights given to a shareholder to determine the business plan and therefore to have a control on the business.
- **Debt/Loan Agreements** – shareholder advance debt or loan collateral giving specific rights related with;
- **Consultancy/Advisor agreements –** influential on the business.

3. The critical role of corporate management

Corporate governance is also influential on the control of an Airline on the control of an Airline. There are three types of corporate governance:

➢ **Managerial governance**
This type of governance is very rare in Africa.
Ownership is institutional, diversified and widely dispersed, but day-to-day management is in the hands of professional executives. Under managerial governance, the strategic and operational control of an airline is in the hands of salaried executives.

➢ **Individual governance**
This type of governance exists in Africa in small Airlines.
Both ownership and control are in the hands of an individual. This type of governance is common in the charter, domestic commuter, and cargo segments of aviation markets. The challenge for individual airlines is attracting the capital necessary to grow to efficient scale. They remain in small market niches, as long as they don't change their mode of governance to acquire the financial resources to move successfully on a larger scale.

- **Stakeholder governance**
  Ownership is shared by various stakeholders (State, banks, institutions, partner airlines…). Day-to-day management is in the hands of professional executives.

  State governance
  This is the most common mode of governance in Africa.
  The 1944 Chicago Convention assured the domestic flag carrier as the dominant model in the Airlines business. States are majority shareholders and nominate the key management people to ensure day to day operations.

  Strategic partner governance
  This is the alternative to State governance.
  In most cases, equity investment by one airline in another is designed to better secure strategic and operational control in a manner that cannot be attained by a commercial agreement such as interline, code share agreement, joint venture or alliance.

  How an airline equity investor will choose to exercise that control will depend upon its own corporate and business strategy. It could be an aviation-services business approach selling a range of aviation services to the controlled airline (consulting, IT, logistics, aircrafts engineering and maintenance, catering business etc…).

  For example, Ethiopian Airlines has acquired equity stakes in numerous African airlines as strategic partner.

4. The European experience

What would be the impact of relaxing Ownership and control rules on the Aviation industry?
What is the experience in other parts of the world?

In EU Ownership and Control rules have been fully liberalised.

Before the EU undertook the project of liberalisation, most airlines were State-owned "flag carriers". The right to operate international flights between States was governed by a network of bilateral air services agreements (BASAs). The flag carriers of the contracting countries and assigned reciprocal traffic rights to the exclusion of competitors.

The European Court of Justice's "Open Skies" judgements of 5 November 2002 found that bilateral agreements providing entitlements only for airlines owned by nationals of a single Member State contravene Community law. The judgement confirmed that the Community has exclusive competence in a number of key areas of European aviation. This meant that only the European Commission is entitled to engage in multilateral discussions with partner countries on these issues (though it needs a specific mandate from the European Council to do so).

The "three pillars" of EU aviation policy were:

1. Bringing existing BASAs in line with EU law by replacing nationality clauses with community clauses;
2. Concluding comprehensive aviation agreements with key strategic partners; and

3. Creating a Common Aviation Area within the EU, and with its neighbouring countries.

Currently, the flying rights of all EU carriers are equivalent for intra-EU flying and flying to third countries which have agreed "EU community clauses" in place of national ownership and control requirements.

5. SAATM and Ownership/Control rules

In 1999, the Yamoussoukro Decision (YD) was a move to follow the liberalization trend in other regions in the world. The main purpose of the YD was to remove operational restrictions on traffic rights, capacities, frequencies and fares.

The pace of the YD implementation had been very slow since.

In January 2018, the African Union (AU) launched the Single African Air Transport Market (SAATM) as one of the AU Agenda 2063 flagship projects. The SAATM is the full implementation of the YD. African countries signing the SAATM commit to fully implement the YD. So far seventy-six (26) States have signed the SAATM commitment.

To speed up the SAATM implementation, a multilateral approach was agreed upon on 28 May 2018 by the signing of a Memorandum of Implementation by fourteen (14) States.

The Article 6.9 ((g) Eligibility criteria) of Yamoussoukro Decision requires Airlines to be effectively controlled by a State Party.

Most African countries require majority domestic equity ownership of designated airlines to ensure effective national control. As a consequence, many Airlines are State majority owned and controlled.

Many of these airlines are characterized by low productivity, poor performance and high operating costs. While their deficiencies are recognized, many States continue to protect them from competition and continue to subsidize them. However, the burden on government for underwriting the losses of national flag carriers and the pressure of Technical Financial Partners (International Monetary Fund, World Bank) encourage many to consider alternatives to State ownership.

Annex 5 Article 7 of YD (Regulation on Air Transport Services within Africa) **"prohibits the granting of any subsidy by any State Party or regional economic community which distorts or threatens to distort competition."** The Executing Agency (AFCAC) shall propose rules on the conditions under which subsidies may be granted.

The SAATM requires a new Aviation Strategy and Policy for Africa. Opening the market access and the development of traffic is expected to create a conducive environment for Airlines.

New developments to separate ownership and control should be considered to tackle Airline equity financing in Africa.

6. Conclusion

Liberalisation and relaxing Ownership and Control rules may create two main concerns which can distort competition:

- The impact of different regulatory rules applying to competitors operating in the same market and in favour of a particular competitor;
- The impact of different regimes governing State subsidies to national flag carriers.

As has been witnessed in Africa, a multilateral approach of Ownership and Control along with competition rules may be more effective in opening-up aviation than a bilateral approach.

By Abderahmane BERTHE
Secretary General AFRAA

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