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How does KLM view the relationship with airports?

[Welcome/Introduction]

Ladies and gentlemen,

- I am honored that I am invited to speak at this conference of the Airports Council International.
- As the only airline man here, I realize that – in accepting this invitation – I have stepped into the lion's den.
- Although, I have been asked to discuss KLM's view on airport charges. I believe this issue should be addressed in a broader context, and I will do so as Chairman of the IATA SPC and member of the AEA Presidents' Committee.
- The relationship between airlines and airports is dominated by a common objective:
To promote aviation as a key industry that brings people together, connecting regions and allowing

passengers and cargo to be transported from one destination to another, anywhere in the world.

[Market]

- Last year, commercial airlines carried 2 billion passengers.
- Everyone in the industry did a fantastic job in making this possible. And we must continue to do so, because we are a growth industry. By 2020, we expect to carry 4 billion passengers!
- That means we must pursue growth to meet this growing demand. This is shared objective of airports and airlines.
- Several factors are important in this regard.
- As you know, airlines are developing and refining two business models.
- The network model sells connectivity at a hub. Passengers fly from A to C via B.
- The point-to-point model offers flights from A to B and back.
- Both models have different consequences for airports. Network carriers need to develop close ties with their major hub or hubs, because convenient and efficient connectivity is an integral part of their product.

- In Europe, transfer traffic accounts for 60% of the total. These transfers are primarily provided by network carriers through one or more hubs.
- Network carriers serve different types of passengers, whose expectations vary with regard to convenience on the ground and in the air.
- Our Business Class passengers demand speed and convenience. Ideally, they want minimum transit times, no queues at check-in, security and gates, and escorted transfers.
- These high-yield passengers will only remain high-yield passengers if they get value for money.
- And then there are the low yield transfer passengers. They are less interested in the standard of service, efficiency and convenience. Price is their priority.
- Airports and airlines have a mutual interest in understanding and meeting the needs of both categories of customers.

[Airlines versus airports]

- Ladies and gentlemen, airlines and airports need to grow together. And we can achieve this if we work together sensibly.
- We are intensifying the dialogue between airlines and airports, to get a grip on the ever-changing demands

and expectations of passengers, and to gain a better understanding of each other.

- We have begun such a high level dialogue between AEA CEOs and ACI EUROPE CEOs.
- During our first meeting, we concentrated on the common desire to foster growth in our industry. We also formed joint focus groups on security, where we have common expertise and interests, and another that will develop a campaign on the industry's efforts to reduce emissions.
- However, despite all these commonalities, we also have structural **differences**, which are important to understand.
- These differences all revolve around the fact that network carriers cannot change hubs.
- It is difficult, if not impossible, for a network airline to pack its business and move to a new airport.
- It took Lufthansa over 10 years to promote Munich as a possible additional hub to Frankfurt – but never as an alternative. Likewise, KLM has very close ties with Schiphol.
- This dependency means that network airlines have little leverage when negotiating the service, design and costs of infrastructure of such hub airports.

- In essence, airports enjoy a monopoly position vis-a-vis their hub carriers.
- This is not the case for point-to-point airlines.
- This reality is reflected by market developments, which show multiple changes of airports for point-to-point carriers but none for network airlines. (Unless they go out of business altogether, such as Sabena)
- Worse still, most airports have little or no financial incentive to reduce their internal costs.
- Airlines are faced with hyper-competition that prevents us from raising prices. We must therefore decrease our costs. Airports, by contrast, seem to be able to generate high EBIT rates irrespective of economic downturns. And this is reflected in the level of airport charges.
- Brussels-Zaventem saw a steep decline in traffic following the demise of Sabena, and responded by dramatically increasing its passenger fees, to cover its costs.
- And Belgacontrol announced it will increase fees in response to DHL's decision to move from Brussels to Leipzig. Neither of the two saw cost reduction as an option to remain competitive, because neither saw themselves as being in a market at all.

[Privatization]

- This situation is exacerbated by a trend towards privatization of airports and the inclination of airports to focus on non-aviation-related activities.
- In principle, airlines do not care who owns an airport, as long as it is efficient.
- But privatization does, of course, give the airport a market value.
- However, if that value is not based on market performance, but derived from government intervention – such as the 5% annual fee increase at Charles de Gaulle during the coming five years – the private investor will expect an unnaturally high return on an unnaturally costly investment.
- And this does not bode well for further efficiency gains at that privatized airport.
- It is important to bear in mind that privatized airports remain monopolists, while at the same time new focus on short-term return is introduced through commercial shareholders.
- Privatization should therefore go hand-in-hand with effective regulation.

- I believe it all begins with a mutual understanding of the need to create a balance in negotiating leverage.
- It would send the right signal to both airlines and airports if the EU were to enforce the implementation of ICAO recommendations – cost transparency, consultation, and cost relatedness.
- Governments worldwide have accepted these recommendations, but their application varies greatly.

Given that European governments have accepted these principles, perhaps we could begin by implementing them in a way that takes full account of the relationship between airports and airlines, including recognition of the legitimate needs of the airports.

[Golden Rules]

- The AEA has formulated Golden Rules for the relationship between the airport and the airline.
- These rules provide incentives for airports to become even more cost efficient and increase productivity at the same time.
- Several countries already pursue economic regulation.
- It does not make sense to urge the EU to duplicate what we already have.

I therefore feel we should take closer look at national legislation, to see if and how it worked.

- We could start with an analysis of Ireland, the UK, or even the Netherlands.
- At home, we do not have effective legal regulation, but we do have an understanding of how we should be dealing with each other. A partnership.
- Some of our experiences may be of interest to other airports and airlines, and I would be more than willing to share this experience so that others can learn. I hope my good Schiphol colleague, Mr. Cerfontaine, will agree to this.
- Ultimately, we could formulate a set of principles for economic regulation, which would be adopted and implemented at a national level. One such principle could be that we must have an independent regulatory body.
- In the UK, Manchester Airport has demonstrated this over the past four years, reducing the average cost per passenger by 38%, significantly outperforming the price caps set by the UK's independent regulator.
- Transparent cost allocation and a commitment to improve efficiency that is seen in the bottom line make Manchester a model for other airports to emulate.
- This is a true partnership, with benefits shared by customers, the airport and the airlines. For this achievement, IATA selected Manchester for the

prestigious Eagle Award.

[Investments]

- Another principle of regulation could ensure that fee increases should remain below the national inflation rate.
- A key concern of many airports has been that airlines failed to see the need for investments and that, in many instances, the fee increases were necessary to fund such investments.
- I disagree. We do see the need for investment.
- In the UK, for instance, BA voiced serious concern about the lack of investment in Heathrow!
- It may be good news that with the change of ownership of BAA, it was announced that the Ferrovial consortium will be fully focused on developing Heathrow Airport. After all, Ferrovial is a constructing company!
- Our future depends on the right long-term investments
- But we do not see why fee increases should be the only way of funding such investments. What we suggest is a procedure for deciding when investment is necessary, and how they should be funded.

- I believe it is in the common interest of airports and airlines to jointly decide upon such investments.
- We all know that non-aviation-related activities at airports are usually more profitable than the aviation infrastructure itself.

- It seems logical that these profits should be used to finance investments in infrastructure.

- With the current practice of cost-plus systems, however, there is a tendency to turn things around. As if a commercial TV broadcasting were to use its programs to finance the commercials, in stead of the other way around!

[Differentiation]

- This brings us to the need for differentiation between users.

- Due to volume and complexity, hub capacity is scarcer than point-to-point capacity.

- It seems perfectly logical therefore that airports differentiate between the two types of users, when responding to the needs of their customers.

- Some will say this is discrimination.

- I believe that is too easy an excuse.

- Our market is not perfect and will never be perfect. That is only because of the political interventions, it is because of permanent scarcity of hub airport capacity.
- The allocation and pricing of that capacity must take into account the different needs of the customers, in joint interest of accommodating the market growth in a sustainable way.

[Conclusion]

- These are a few of the Golden Rules and principles which I feel should govern the relationship between airlines and airports. I sincerely hope they will be in place before privatization begins!
- European airlines and airports must get their act together so that Europe can remain globally competitive.
- All of these steps should be based on mutual trust and understanding.
- In that sense, today's conference is another step in the right direction, promoting the dialogue between two very important stakeholders.
- I thank you for giving me the opportunity to contribute to this process!

[1812 words]