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**Globalization – The Final Chapters?
The Pilots' Perspective
by
Captain Dennis J. Dolan, President
International Federation of Air Line Pilots' Associations**

Good afternoon ladies and gentlemen.

I would like to sincerely thank the European Aviation Club for inviting me to address you today, and I hope my remarks will be both revealing and thought provoking.

Before I talk about the subject of globalization I would briefly like to give you an overview of the International Federation of Air Line Pilots' Associations (IFALPA)—who we are, how we were formed and what we do. The Federation was formed in 1948 in response to the formation of the International Civil Aviation Organization (ICAO), which was established just after the end of World War II. Pilots felt at the time that they needed to be involved in the decision making process when rules and standards regarding international aviation safety were being promulgated. IFALPA has been successful in obtaining this goal, and is currently one of only two organizations that have Permanent Observer Status at ICAO, with IATA being the other. Currently, IFALPA represents over 100,000 pilots in 95 countries worldwide, and our mission is to be the Global Voice of Pilots on international issues. Just this year at our Annual Conference we welcomed the Chinese Air Line Pilots Association into IFALPA, which we consider to be a major step in the evolution of aviation in China, and in the international piloting community. As you will see later in my remarks, I believe China will have a major impact on the aviation industry in terms of both market presence and market influence.

Let's switch to the subject of today's remarks—globalization. Back in the early 1990s, globalization was, in the aviation industry, just another catchy word. Although many industries had already either undergone globalization or were in the process of globalizing, the aviation industry was still in a mode of contemplating this phenomenon. I don't believe that to be the case anymore because the industry is, in many ways, heavily globalized and moving toward complete globalization. The question, then, is how close are we to the end game of realizing a fully globalized industry? Are we indeed in the final chapters of this evolution? If so, what are we doing about this movement—"we" meaning pilots specifically

and the industry generally? To answer some of these questions let's take a look at what we mean by "globalization," where the industry sits at the present time based upon that definition, and where it might be headed in the future.

Globalization

Loosely defined, I believe globalization is the proliferation of the major sources of capital within a particular industry into the most lucrative worldwide markets within that industry. Now, that's just a fancy way of saying that the big players in an industry are free to establish, with no restrictions other than those imposed by the marketplace, a global market presence by establishing, expanding and leveraging their capital investments in a transnational way.

Where does the aviation industry currently fit in this definition? I think the answer is, clearly, that the industry is in an expanding global mode but has not yet reached a pure form of globalization.

Alliances

If you look at the industry as currently structured from a global perspective, you see that the Alliance is the commercial relationship of choice. The Alliance format represents a major step forward in globalization of the industry because it allows a given company to project its capital to major areas of the world via code sharing, and in some cases, revenue sharing schemes. These relationships provide a global means of brand promotion and identification through seamless travel arrangements between two points from virtually any aviation market in the world. However, Alliances are still subject to a number of restrictions—such as restricted traffic rights, anti-trust provisions and ownership restrictions, to name a few. These restrictions preclude the Alliances from achieving the purest form of globalization. Alliances have, however, set the stage for progression to the next level of globalization once some or all of these restrictions are lessened or removed entirely.

Let me interject here how pilots deal with Alliances. In the mid nineties, when the big Alliances were beginning to come into their own, pilots responded by forming Alliances of their own. The four initial pilot Alliances that evolved were: the Associations of Star Alliance Pilots, the Global Pilots Alliance, the Oneworld Cockpit Crew Coalition and the Wings Pilot Alliance. Somewhat later the TUI Pilots Alliance was formed. These Alliances have now evolved into four groups, with the Global Pilot Alliance and Wings being absorbed into what is now known as the Sky team Pilots Alliance. The reason these pilot organizations

were formed is because pilots view themselves as stakeholders in this industry and they believe they need a formal platform from which to deal with other stakeholders, which of course would include Alliances. The formation of these pilot Alliances was intended to give pilots a more international presence with respect to issues of globalization. In fact, pilot Alliances have formal governing structures and committees to specifically address Alliance issues, and the goal of these formal structures is to provide a means by which to constructively engage their corporate equivalents.

Unfortunately, to date such engagement has been sparse to non-existent. Apparently, the Alliance managements view the relationships with the pilot Alliances as strictly industrial in nature. I think this circumstance is unfortunate, since I do believe pilot input into Alliance activities could be beneficial in many respects, especially on the safety and operational side of the equation. This is a situation that is ripe for a constructive and productive relationship between two of the groups that are likely to play major roles in the next phase of globalization. I have to ask rhetorically, why aren't we seeing this relationship develop?

Instead, at the present time pilot Alliances are left to deal with issues amongst themselves, and this activity has been focused mainly on assuring that the large Alliances do not take advantage of their respective pilots by pitting one group against the other through reallocation of flying and the like. As we leave the subject of Alliances I would stress that they represent the outer limits of globalization of the aviation industry at this time, and provide the platform from which an expansion of globalization will be launched.

The State of the Industry

Let's switch focus now to the state of the industry. For the most part, all industries are dynamic in nature and aviation is no exception. I think recognizing this dynamic element and the change it can facilitate is important, because it will provide the vehicle by which the industry moves to a different level, in this case the next level of globalization. At this point in time we could say the state of the aviation industry is the classic case of good news/bad news. On the one hand, most of the world has not only recovered from the effects of the September 11 terrorists attacks, the SARS epidemic etc., they have actually begun to show some healthy financial results, and in some cases exceptionally good results. Of course, the recent spike in oil prices has dampened this surge a bit.

On the other hand, the US carriers, especially the large, established carriers—or Legacy Carriers as they are often referred to—have not realized any such recovery. In fact,

their woes only continue to grow and their losses continue to mount, now reaching tens of billions of dollars over the past several years.

What this picture reveals is that the largest aviation market in the world now has the weakest carriers in the world underpinning it. On top of that, if a number of these carriers begin to fail or disappear for various reasons, access by the stronger carriers outside the market is still very limited due to some of the points I previously made, such as route restrictions and foreign ownership limitations. This dichotomy will put pressure on the industry to consider major shifts that could push globalization forward.

Globalization Moves Forward

Let's talk about this possible major shift for a moment, and how it might come about. What I mean by a major shift is that the industry could move off of the current status quo and enter the next major phase of globalization, which would go beyond the current limits that are defined by the Alliance relationships. There are two ways I see this shift coming.

One would be for a gradual change to occur, such as an agreement between the EU and the US to change traffic rights and foreign ownership rules, with these changes phased in over several years. This change would bring about possibilities of new or increased expansion, including equity stakes within the existing Alliances, or perhaps even the formation of new Alliances or other cooperative commercial relationships.

A second way for this shift to occur could be what I refer to as a "triggering event" that would push this timetable up dramatically. Some possibilities that could be considered triggering events would be a further drastic upward spiral of oil prices, to say \$100 a barrel, or another serious terrorist incident. I think we have to ask ourselves, if this "triggering event" occurs, how would that affect the industry?

My belief is that you would see the extremely fragile US industry pushed to the brink of viability. In that case the result would be a rapid and aggressive round of consolidation of the weaker carriers, first internally within the US, then quite probably cross border and even cross ocean. It is possible that the US government might facilitate this process by approving a much broader open skies agreement with the EU in an attempt to stave off a partial collapse of the US industry. In fact, because of the size of the US market, as a measure of origin and destination traffic, I believe many foreign carriers would find it viable and attractive to participate in this consolidation. Many of the larger non-US Alliance partners currently have the financial wherewithal to make this scenario possible if they so desire.

You may ask, why do I think such a scenario would result in consolidation? Frankly, history shows us that in just about every case industries that have gone global have done so through consolidation. I cite the automobile, petro-chemical and banking industries as examples. As we all know, history has a tendency to repeat itself.

In either case, whether the movement towards the next phase of globalization is slow and deliberate, or whether it becomes accelerated, I think the question for all of us is what are we doing to prepare for this eventual, and in my opinion, inevitable change?

The China Factor

More on how we answer this question in a few minutes, but let me digress slightly and focus on China. Earlier I stated I believe they will play a role in any significant movement of the airline industry in the future. I believe this because if you look at China and how they are currently progressing in both the world economy and in aviation, it is hard to argue that they will not become a dominating force in both, if they have not already begun to do so.

In the aviation industry China has the potential to become the largest aviation market in the world. Mainland China is roughly the geographical equivalent of the continental United States, which is currently the largest aviation market. In terms of population, China has four times as many people as the United States. Think for a moment what this most revealing statistic means in terms of the incredible potential in the China market.

And I believe this potential is beginning to be realized. As you may be aware, China is rapidly expanding its aviation horizons and has predicted that its capacity will double by about 2012. That's an incredible rate of expansion, and the affect this will have on the industry at this point in time is a great unknown. So, what role will China play in the big push toward globalization remains an unanswered question at this juncture but, nevertheless, it is a point that cannot be lost on anyone.

Consolidation

As we did with Alliances a few minutes ago, I think it would be beneficial to talk for a moment about consolidation. Consolidation in the airline industry is not a new phenomenon. In fact, there has been quite a bit of consolidation around the world in the last 30 years, primarily as a result of the deregulation of the US industry in the late 1970s. Most recently we have seen consolidation in Japan, Canada, Europe and the United States. Obviously, with this process already incrementally underway I don't think it is much of a

stretch to see how it could rapidly accelerate under the conditions I outlined above. If and when it does take on a more aggressive movement I believe the process of globalization moves forward as well.

Now let's take a look at consolidation from the pilots' perspective. Pilots, and other airline staff for that matter, have an old saying when it comes to consolidation, and that is: one plus one equals one and one-half ($1 + 1 = 1 \frac{1}{2}$)! What this means in real terms is that the effect of consolidation—in fact by definition the very goal of consolidation—is to eliminate inefficiencies and duplication in order to realize the synergies of the merger of the two companies in terms of the administration and operation of the newly formed company. Invariably, attaining part of these synergies will cause a decrease in the number of employees needed from the old companies to operate the new company. Thus, $1 + 1 = 1 \frac{1}{2}$.

This reality is obviously an issue with pilots from several aspects, especially those pilots that operate within seniority based systems. First, a merger or acquisition can have a very marked affect on career advancement, especially if the merged pilot group realizes promotions as a result of seniority. This element in turn can have an effect on pay and benefits as well as quality of life issues such as when a pilot may obtain his annual leave. This is why seniority list integration is one of the most difficult and acrimonious processes for pilots to endure. I have been through a merger and I can tell you first hand that these problems are very acute, and can cause hard feelings for many years.

Second, there are operational and safety issues that also arise as the result of a merger. No two companies in any industry are run exactly alike, and in fact, most companies have their own personalities and cultural history. This has an influence on how operational procedures and philosophy are developed and presented in the new company. How well these details are addressed can have a direct affect on flight safety.

Finally, the historical pattern for most mergers involves a financially strong carrier acquiring a financially weak or even failing carrier. Once the company is combined both sets of pilots involved now have the added angst regarding how successful the newly formed company will be, since their careers are so closely tied to the carrier's fortunes. This factor can also have a bearing on how smoothly and safely the new company operates. So, you see, consolidation involves so much more than just financial and regulatory issues. In fact you are creating a new entity with a new personality.

What are the Challenges Here?

Now let's refocus on the question I posed a few moments ago—What are we doing to prepare for an eventual and, in my opinion, an inevitable change in the industry. Here is how I would answer this question.

If we accept the fact that the consolidation which has already taken place is a precursor to further consolidation, then I believe we all have some hard work ahead of us. I believe that all of the stakeholders in the industry—pilots, other staff, managers, regulators and governments—need to begin a process of constructive engagement **NOW** in anticipation of the possibility of more consolidation.

- We need to jointly develop a process to minimize the human sacrifice brought on by this evolution
- We need to address workplace integration issues from a safety and cultural aspect
- We need to set a goal of producing a motivated workforce in the newly formed company
- And we need to commit to producing a better product. Aviation is, after all, a service industry, and I think our image has suffered a great deal over the past several years in regards to service. I think we can do better, and we must.

Thinking about and beginning to address these issues now will prevent us from having to develop these measures in a crisis if one of the "triggering events" I mentioned earlier accelerates this process.

Pilot Preparation

Let me now discuss what we as pilots are specifically doing to prepare for these eventualities. In my speech to the IFALPA Annual Conference held last April in Cape Town I made several recommendations on this subject to the leaders of our Member Associations. These recommendations were intended to be of an introspective nature, and the first was that they review their relationship with the managements of the various carriers they represent. As previously stated, I believe very strongly in developing constructive relationships with the other stakeholders, and this is particularly true for pilots with the managements of the individual carriers for which they fly. Issues as complex as consolidation are difficult to deal with when the relationship is good, but can be impossible to deal with when the relationship is strained or non-existent.

I then asked them to review the resources they had at their disposal to deal with a major event like consolidation. As you would expect, many of our smaller associations have

limited means in this regard, while some of our larger associations and affiliated groups have a great deal of experience and resources. The European Cockpit Association for example, is in the process of developing merger policy for its Member Associations, many of whom are also members of IFALPA. It is this sort of progressive thinking and planning that I am trying to encourage amongst pilot leaders all over the world.

IFALPA is also in the process of restructuring the way it is governed. We approved at the Conference in Cape Town a structure that will give us the means to be a more decentralized organization. In this way we will be able to more effectively address regional issues that arise.

IFALPA is also in the process of developing a training curriculum for elected leaders. In many instances the pilots who step forward to assume the leadership of their organization may have a very limited background in the actual business of representing pilots.

We hope to be able to provide them with the basic skills necessary:

- To allow them to establish a good working relationship with managements and regulators
- To be able to effectively communicate with their pilots, their management and the public
- And to run their organizations in a business like manner.

Finally, one of the strengths of an organization like IFALPA is its ability to provide a forum for networking amongst its Members Associations. It is through this networking that we can share both experience and ideas, and perhaps guide some of our colleagues through a difficult business transaction like a merger by putting structure and discipline into the process.

Conclusions

Let me sum up these remarks by highlighting a few of the points I made along the way.

- There are changes ahead that will push globalization toward its final shape
- These changes may come more rapidly than anticipated
- China, because of its sheer size, its growing economy and the potential of its aviation market will play a prominent, but as yet undefined role in globalization
- We must all prepare **NOW** to meet the challenges we know are about to occur
- Pilots are stakeholders in the industry and have a career interest in making it succeed
- Pilots realize the value of constructive engagement
- Pilots are preparing for the next phase of globalization

I'll end with one final thought. We know the challenges of globalization are on the horizon and that we need to prepare to deal with them. I believe the final chapters are about to be written and working together we can shape a dynamic and efficient globalized industry. I challenge all of us not to let this opportunity slip away.

Thank you.