DAVID KNIBB SEATTLE

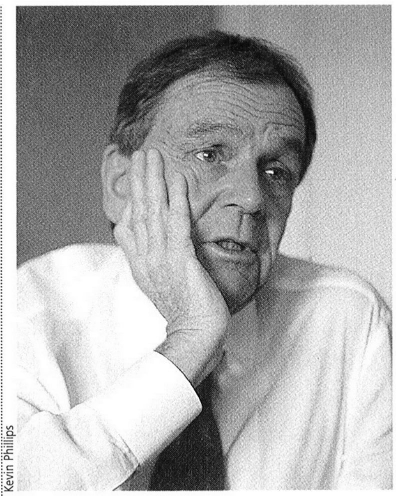
Qantas announces cost-cutting plans

Qantas has set a controversial goal to cut costs by A$1 billion ($663 million) over the next two years. Part of this restructuring could be the launch of a low-cost domestic carrier.

Prompted by concerns over the cost of capital, growing domestic rivalry from Virgin Blue, and the airline's first ever half-year loss, Qantas chief executive Geoff Dixon has announced plans to spin off eight divisions into standalone units – including flight operations, engineering and maintenance, and catering. Each will have its own managers, budget, and profit targets. The carrier is studying the feasibility of a low-cost unit, which would be separately managed. It expects to come to a decision on this in November.

Merrill Lynch calculates that Qantas must cut operating costs by 10-15% to compete on costs and regain its leadership in key markets. Dixon warns: "This is an industry in meltdown," and that Qantas must "get rid of some of the inefficiencies that have been in place over the past eight years".

Unions have reacted by accusing Dixon of using or creating a crisis as a smokescreen to push through changes. Labour leaders are especially sceptical because the proposed restructuring calls for half the cost cuts to come from labour.



Kevin Phillips

Qantas chief executive Geoff Dixon warns the industry is "in meltdown"

No-one, however, disputes that Virgin Blue is a growing concern. As Merrill Lynch warns, Virgin Blue "has been relentlessly winning market share" and could become a full-service product "if not stopped now". Virgin claims that its market share over the past 12 months has climbed from 17% to 28%.

Dixon doubts that Virgin can keep growing at that pace, but he has previously warned that Qantas would not idly watch its rival expand. The proposed low-cost Qantas unit seems a project designed to draw a line in the sand on market share. "We believe that about 65-70% is what Qantas must defend and we're going to defend it," Dixon declares.

Analysts are divided on the low-cost plan. A discount carrier will cannibalise Qantas traffic, they predict, but it may be needed to stop Virgin Blue and discourage other potential start-ups.

Virgin Blue has also been moving away from a traditional low-cost model. Business lounges, interlining with more codeshare partners, and preferred seating have lured business passengers from Qantas. Analysts foresee renewed interest by Singapore Airlines in domestic Australia, with a chance that it would align itself with Virgin Blue as the latter becomes more like a full service carrier. Qantas recognises it is necessary to act now to curb Virgin Blue's growth before the rival expands further.

Fiji dampens pacific market proposal

A proposed single aviation market between Pacific island nations and Australia and New Zealand has received a setback by Fiji's decision to opt out of it.

The Pacific Islands Air Services Agreement (PIASA), drafted on behalf of governments in the region, was first offered for signature in August at the annual Pacific Island Forum meeting of government heads in Auckland. PIASA proposes open skies, including fifth and sixth freedoms, between all nations that sign the accord.

It could replace up to 67 bilaterals that now govern air travel within the region. More importantly for small island nations with limited capital, it would ease foreign ownership limits by allowing them to pool investment in jointly-owned airlines.

PIASA could replace up to 67 bilaterals governing air travel in the Pacific region

Fiji chose not to sign due to concerns that the deal would allow Australian and New Zealand airlines to dominate. Fiji and New Zealand have a history of aeropolitical tension. Karam Chandra, Fiji's civil aviation director, told *Airline Business*'s sister on-line publication *Air Transport Intelligence*: "Open skies agreements appear to have run their course and many have found that the benefits that were loudly proclaimed do not, in reality, occur."

Chandra goes on to warn: "The largest carriers retain or grow their strength at the expense of the small because major multinationals that have more resources have been able to force out local airlines."

Fiji's opt-out is a setback, because its location makes it a transport hub among Pacific islands. Yet, it is still possible that PIASA may take effect. Four island nations (the Cook Islands, Nauru, Tonga, and Vanuatu) signed in August and at least one other (Solomon Islands) has expressed an interest. Six are needed for PIASA to take effect.

Australia's prime minister, John Howard, is pressing for shared airline ownership and operation among Pacific island nations, and Australia is funding a study on ways to do it.

In brief

Shanghai boosts 757

China's Shanghai Airlines has given a boost to Boeing's ailing 757 line with an order for five 757-200s. The order comprises three aircraft for delivery in the first half of next year and two for delivery in spring 2005.

JAL to acquire more 777s

Japan Airlines (JAL) is planning to acquire seven more Boeing 767-300ERs by the end of September 2006 on operating lease. The aircraft will be powered by General Electric CF6-80C2 engines and will replace the carrier's ageing fleet of 12 McDonnell Douglas DC-10s.

ANZ takes first A320

Air New Zealand (ANZ) has taken delivery of its first Airbus A320. ANZ has 15 A320s on order with Airbus and leasing companies to Boeing 737s and Boeing 767s on short-haul international routes. The first aircraft is on lease from ILFC.