Competition and Collaboration:

The New Challenge Facing Hong Kong International Airport

Since Hong Kong International Airport (HKIA) opened in 1998 under the Airport Authority of Hong Kong (AA), it has established a reputation as one of the most modern and efficient airports in the world. The HKIA's superb design and modern facilities provide a quality of service to travelers that set the standard for airports in the 21st century.

But HKIA's future is by no means assured. The airport faces a range of business issues, with competition from neighboring airports – especially those in the burgeoning Pearl River Delta (PRD) – high on the agenda. Ironically, competition brings with it important new opportunities as HKIA is clearly an integral part of the PRD success story and will be able to benefit significantly from its growth.

HKIA has redefined its business, redefined its market and redefined its product. It sees itself as the centre of integrated multi-modal flows of people, goods, information and capital. It is reaching out to the source of these flows, with a focus that has moved far beyond Hong Kong and now sees the whole of China as its new "expanded home market".

HKIA is now therefore entering a period where it will compete and co-operate at the same time. Competition means ensuring it wins a robust share of the regional airport business, recognizing that the Hong Kong market alone will not give it the flow of business it needs to grow over the long term. But it also understands that it is not a simple matter of "stealing" business from its neighbors. HKIA must spend just as much energy co-operating with airports in China as in competing with them. And there can be no "zero-sum game". There is no benefit in simply moving business from one part of China to another. Cannibalization is not the way forward. The challenge for HKIA and its competitors is to find a win-win solution by developing business strategies that enlarge the pie so all players benefit. If China's airport and aviation sector thrives, HKIA will thrive and so will its neighbors. All boats rise on a high tide.

How can HKIA ensure this happens? What steps must it take to ensure it plays a distinct role in developing China's wider aviation business, both in passenger terms and in cargo terms too? Success will ride on finding a solution.

After seven years of successful operations, HKIA has essentially completed its first phase of development. It reported significant profit growth in 2005 and expects steady growth in coming years. HKIA has progressed from its origins as a project-oriented organization to a customer-focused corporation and continues to mature as a commercial business.

The AA has formulated a strategy that will underpin a new era of success by grasping and responding to new commercial realities. Will the new strategy work? How can HKIA remain competitive? How can HKIA grow? What scale of growth can be expected in China's aviation sector? Will China's growth be sufficient to create the win-win situation required? Will HKIA be able to provide leadership in this context? Is the AA's vision of China as the new "home market" the right one? What are the business drivers for a collaborative future? What kind of investment will reap the best rewards? And is it all down to HKIA and its neighbors in the PRD and beyond? Or is there also a role for the Hong Kong Government or even local and central government bodies in China?

HKIA Captures the Attention of the World



The Airport Authority Hong Kong (the AA) is a statutory corporation wholly owned by the Hong Kong SAR Government. Its purpose is to operate and develop Hong Kong International Airport (HKIA), one of the world's busiest international airports, a hub for the region and a key gateway into China. More than 69 airlines operate over 4300 flights a week from HKIA to more than 130 destinations worldwide. Some 38.3 million passengers and over 3.1 million tonnes of cargo passed through the airport in the last financial year ending March 31st 2005. In the same period, HKIA saw 242,000 aircraft movements. With 50% of the world's population within five hours flying time, HKIA is a multi-modal international aviation centre and regional superhub.

From difficult beginnings with a chaotic initial opening, HKIA has progressed by leaps and bounds. Highlights in the latest financial year 2004/05 underline this:

- Valuair launched its scheduled daily flight service between Hong Kong and Singapore, becoming the fourth low cost carrier to operate out of HKIA after Cebu Pacific, Orient Thai and Australian Airlines.
- The HKIA paid its first dividend to the Hong Kong Government in June 2004.
- Heavy overseas travel during the Lunar New Year holiday in February 2005 boosted the month's passenger throughput to over 3.1 million, an increase of almost 29% over the same period the previous year. Some 150,000 travelers passed through the airport on the single day of 13th February.
- Last March, HKIA was named the Best Airport Worldwide for both business and leisure travelers by the authoritative AETRA survey run by the International Air Transport Association (IATA) and Airports Council International (ACI).
- HKIA's accomplishments are recognized internationally. In April 2005, for example, Skytrax – a UK-based airport and aviation research group – named HKIA the world's best airport for the fifth consecutive year. Travelers of more than 80 different nationalities participate in this global study.

The success story goes beyond the last financial year. Since 1998, HKIA has enjoyed a consistent record of achievement.

It has established high levels of safety, security, quality services and operational efficiency. In security, for example, it performs 100% baggage checking. It has set

new records in the number of aircraft movements and passenger and cargo throughput, making HKIA one of the busiest international airports in the world. There has been good growth in cargo volume.

It has established successful retail and advertising revenues. Transport links into Hong Kong and key PRD cities have improved significantly. Airline passengers transferring at HKIA, for example, now enjoy excellent transfer facilities and shorter minimum connection times between flights.

The AA has invested consistently in IT to ensure HKIA remains one of the most technologically advanced airports in the industry. It has been in profit since the 2000/01 reporting year (ended March 31st) and enjoys credit ratings equivalent to Hong Kong's sovereign ratings.

Squaring Up to the Future

Nobody can accuse HKIA of resting on its laurels. The AA knows there's no room for complacency. There is clear evidence that the AA is focusing carefully on developing the right strategy for the future. A key point is that everybody associated with running HKIA understands that it is much more than just an airport. It is becoming a centre for the integration and management of multi-modal flows of people, goods, services and information.



Against this background, the AA has made it clear that its overall mission is to attract and develop in a sustainable manner the flow of value-adding activities to Hong Kong, the Pearl River Delta and southern China.

HKIA is adopting new measures to achieve a high level of efficiency, integrated supply chain management, comprehensive facilities and services and fast response to change. Its aims to maintain a leadership position in airport management and aviation-related business as a means to strengthening Hong Kong as a centre of international and regional aviation. In particular, it seeks to:

- uphold high standards in safety and security
- operate efficiently with care for the environment
- apply prudent commercial principles
- strive to exceed customer expectations
- work in partnership with stakeholders
- value human resources
- foster a culture of innovation



In 2002, the AA announced its 2020 Master Plan that provides the blueprint for HKIA's growth and development for the next 20 years. This articulated 10 major projects encompassing passenger services, cargo and logistics, the SkyCity commercial development and further integration with the Pearl River Delta. The new Master Plan views the airport as one of the key economic drivers of Hong Kong. As high-tech and high-value manufacturing in southern China continues its rapid growth, continual expansion of logistics facilities is a key requirement in the face of Hong Kong's growing potential as an international and regional logistics hub.

The Regional Roles of HKIA

Hong Kong has long been considered the “Gateway to China”. It enjoys being no more than two hours flying time away from an area with more than 800 million Chinese citizens, with this area including the economically vibrant Yangtze River Delta.

HKIA’s future and long-term fortunes will be closely connected to the future and fortunes of the PRD. Hong Kong is directly adjacent to the PRD – it can even be considered to be strategically located within the PRD. This has long been one of the fastest-growing economic regions in the world with exceptionally high levels of productivity. Its status as an economic powerhouse is driven by its vast hinterland and resources as well as by Hong Kong’s knowledge, expertise and wealth.

Hong Kong’s role within the PRD can only grow. There are many factors for this. Making Hong Kong a transportation hub is a key part of the Hong Kong Government’s determination to enhance Hong Kong’s role as a regional financial centre and a centre for multinationals’ regional headquarters. HKIA can clearly facilitate this through its role as a key component of Hong Kong’s transportation infrastructure and as an intermediary between the PRD economy and the global market. The AA has looked beyond HKIA’s role in air transport and has actively encouraged the development of a multi-modal transportation system that complements air with land and sea links.



The number of Mainland Chinese visitors using the airport is growing all the time and this is prompting moves to build traffic further. In 2004, for example, the Hong Kong Government announced that it would increase air traffic capacity between the Mainland and Hong Kong. A Task Force set up by the HKIA conducted in-depth reviews of five major areas involving 17 airport systems. These included power and water supply, people and luggage movement, building management, aircraft handling as well as information and communications.

While Hong Kong’s geographical proximity to the Mainland has provided HKIA with a competitive advantage over many of the new regional airports, it still faces a boundary that artificially separates Hong Kong from the major source of traffic flow - China. This barrier has made HKIA’s traffic increase at a rate that is disproportional to the dramatic economic growth on the Mainland. The major Mainland airports of Beijing, Shanghai and Guangzhou have significantly increased their traffic. Other airports like Hangzhou. Chongqing and Shenzhen have also recorded strong traffic growth in the past few years.

The AA is addressing the issue of creating seamless border crossings for both passengers and cargo.

HKIA as a Major Asian Hub

HKIA is more than a gateway to China; it is Asia's largest aviation hub. Ease of travel, an excellent airport environment and convenient connections make Hong Kong attractive for business visitors and the international conference and exhibition industry. A first class cargo processing capability makes Hong Kong more attractive for both manufacturing and related service industries. HKIA is a major factor in Hong Kong's appeal to overseas direct investors. The HKIA has said it aims to strengthen the airport's attraction in all these respects.

An important development in the context of Hong Kong's status as an Asian hub is the US/Hong Kong air services agreement signed in 2002. Helping to liberalise air transport in the interests of Hong Kong, the agreement allows code sharing between US and Hong Kong airlines. This enables US carriers to reach more Asian destinations via Hong Kong, and also allows Hong Kong carriers to provide through services to more destinations within the US. US carriers are provided with rights to operate more "5th freedom" services from Hong Kong, thus helping to consolidate the role of HKIA as a regional and international hub.



How Does HKIA Make Money?

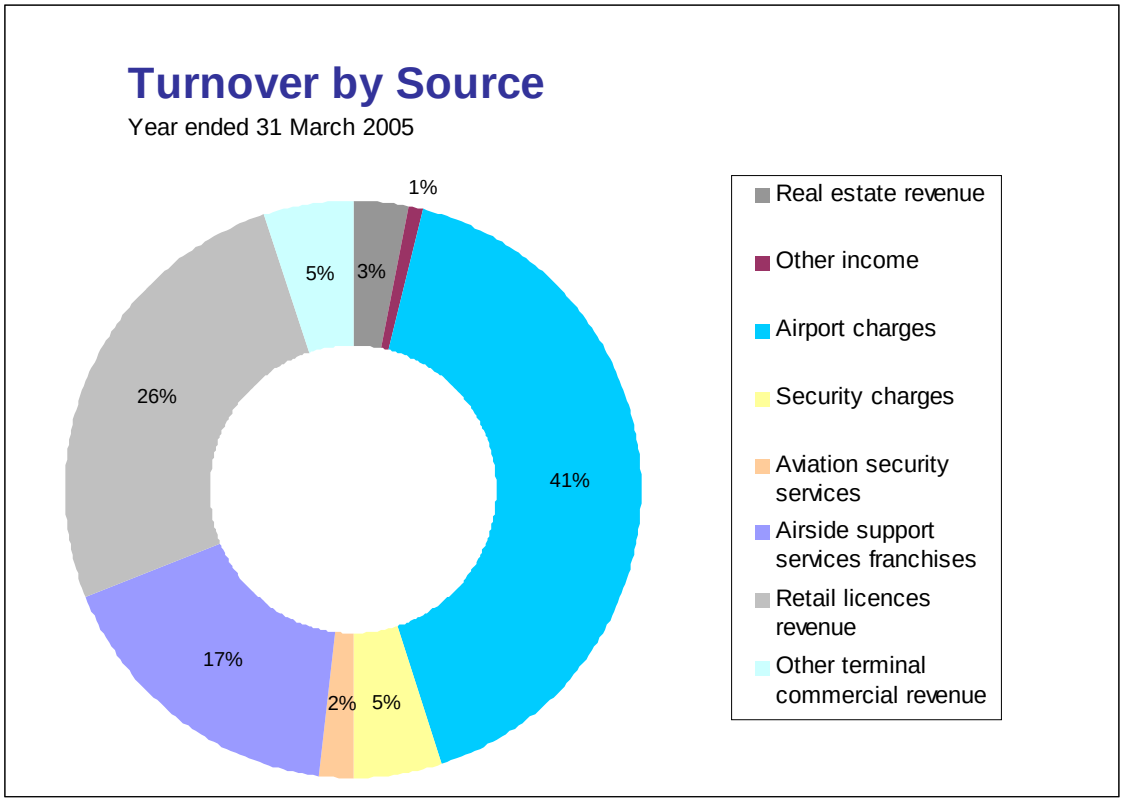
HKIA is now a successful and profitable business. The latest financial year saw record growth with turnover up 29% and reaching more than HK$6.5 billion. Profit attributable to shareholders was HK$1.41 billion. This represents a more than 265% increase over the previous year and a 181% growth on 2002/03. This remarkable increase in profitability was primarily driven by record revenue and complemented by a well-contained operating cost base. Return on net assets was also notable, with the 4% level reached in 2004/05 a significant improvement on the levels of the previous four years where the return never exceeded 1.4% and was as low as 0.2%. Part of the increased return on net assets was driven by an improved capital structure after the repayment of HK$6 billion capital to the Hong Kong Government. HKIA's return has now reached a level that is close to similar infrastructure companies in Hong Kong.

Operational Highlights *	**2004/05**	2003/04	+/-%
Total Passengers (millions)	**38.3**	27.7	38%
Cargo Tonnage (millions)	**3.1**	2.7	15%
Aircraft Movements (000's)	**242.0**	190.0	27%
Financial Results *	**2004/5/1**	2003/04	+/-%
(in HK$ millions)			
Turnover	**6,506.0**	5,039.0	29%
EBITDA	**3,703.0**	2,347.0	58%
Profit Attributable to shareholder	**1,410.0**	386.0	265%
Dividend Declared	**1,000.0**	380.0	163%
Net Assets	**32,394.0**	37,364.0	-13%
Total Borrowings	**10,714.0**	7,778.0	38%
Return On Net Assets	**4 %**	1 %	288%
Standard & Poor's Credit Ratings:			
Long-term local currency	**AA-**	AA-	
Long-term foreign currency	**A+**	A+	
* Year ended 31 March			

HKIA's has five main operations, as follows:

- Airport charges
- Terminal commercial revenue
- Airside support services franchises
- Aviation security services
- Real estate revenue

Airport charges (the money airlines pay to fly into and out of Hong Kong) and terminal commercial revenue (mainly from retail licenses) are HKIA's key sources of revenue. These constituted 41% and 31% of turnover respectively in the year ended March 31st



2005. Airside support services franchises – such as Hactl's air cargo operation – accounted for 17% of revenue.

HKIA's business are growing

The reason for the increase in HKIA turnover in the last financial year was primarily the rise of passenger and cargo traffic, followed by increased revenue derived from restructured licensee contracts and introduction of new business initiatives including SkyPier, the East Hall Expansion and the DHL Express Cargo Centre.

These developments have a direct impact on HKIA's performance. Revenue from airport charges and security charges, for example, increased by 29% to HK$3.033 billion. While the increase will be welcomed by HKIA, it is acutely aware of the need to set cost-effective charges that enable the airport to be competitive with other major international airports. It is succeeding in this regard. A review by the Transport Research Laboratory of 2004 airport charges of major international airports indicated HKIA's charges remain competitive, ranking 46 out of 50. In addition to maintaining competitive charges, HKIA is building demand for the airport among airlines through international marketing and has offered incentives to encourage airlines to fly to new destinations from Hong Kong. These incentives involve landing fee rebates that have been well received by airlines.

Airside support services franchises registered growth of 21% over last year reaching HK$1.087 billion. This reflects the exponential growth of cargo flow in the PRD region, particularly in the express cargo area, resulting in significant revenue growth for nearly all franchises providing airside support services. DHL's Express Cargo Centre, which commenced operations in June 2004, performed better than its business plan after only six months of activity. DHL is already considering an expansion plan that was originally scheduled for 2009. The balance of HKIA's revenue growth in airside support services came from the increase in facility payments for the aviation fuel system.

Retail is a key business segment for HKIA. The airport has contemporary shopping malls with over 150 world-class retail outlets. HKIA regularly monitors spending patterns and customer types to ensure that the right facilities and services are provided at all times. The focus on retail reflects a broader strategy in which the AA is transforming HKIA from an infrastructure business to a service business whose exclusive product is the HKIA "experience".



Following early success with retail operations, some 8,300 square meters of new shops, restaurants, cafes and other attractions were added to the terminal. The main focus was on a major extension to the East Hall, the principal airside retail area. This virtually doubled retail space in the area on completion. The aim of this work was to help meet the tourist boom that is taking place with the opening of Hong Kong Disneyland. The East Hall extension created additional retail space of some 7,000 square meters offering an excellent trading environment for operations and an exciting trade mix to customers.

The AA has also implemented improvements to the SkyMart retail mall, a facility that is already on a par with Hong Kong's premier shopping malls. A special logo has helped position SkyMart as the place where departing passengers can indulge all their shopping needs. The mall is now successfully positioned as a comfortable alternative to downtown retail with a flavor that sets it apart from retail provision at other airports. This has built a strong income.



The last financial year clearly reflected the success of retail business which set a sales record with a 60% increase over the previous year. This directly impacted

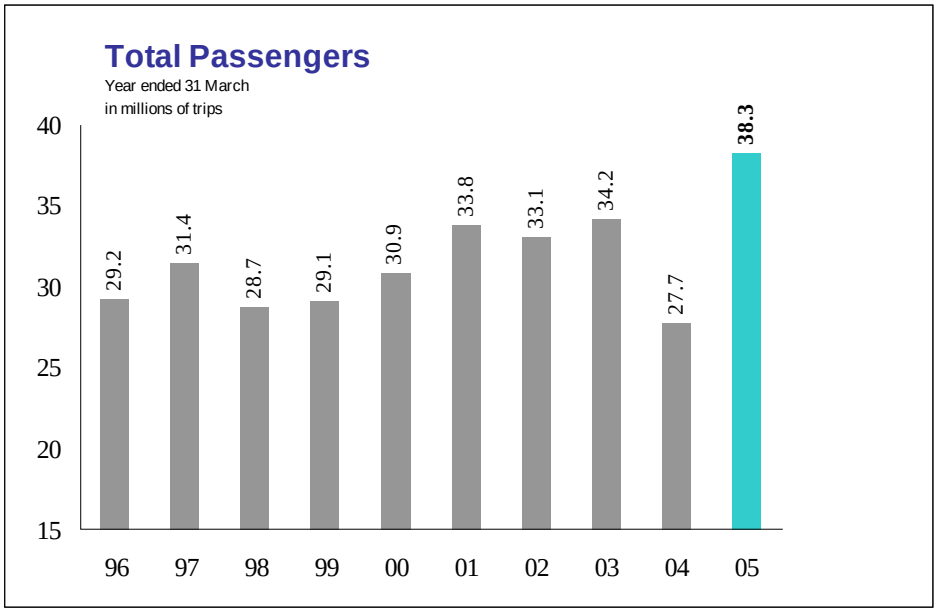
HKIA's terminal commercial revenue with income from retail licenses enjoying impressive growth of 46% and 24% compared to the previous two years. Much of the increase came from the full-year benefit of the East Hall extension.

A new revenue stream has been established from external advertising and HKIA continues to develop terminal advertising beyond the electronic format of LED and projection advertising. For example, it has launched sponsorships of internet stations. HKIA's advertising sales in the latest financial year increased 65% over the previous year. This all bodes well for the overall category of terminal commercial revenue going forward.

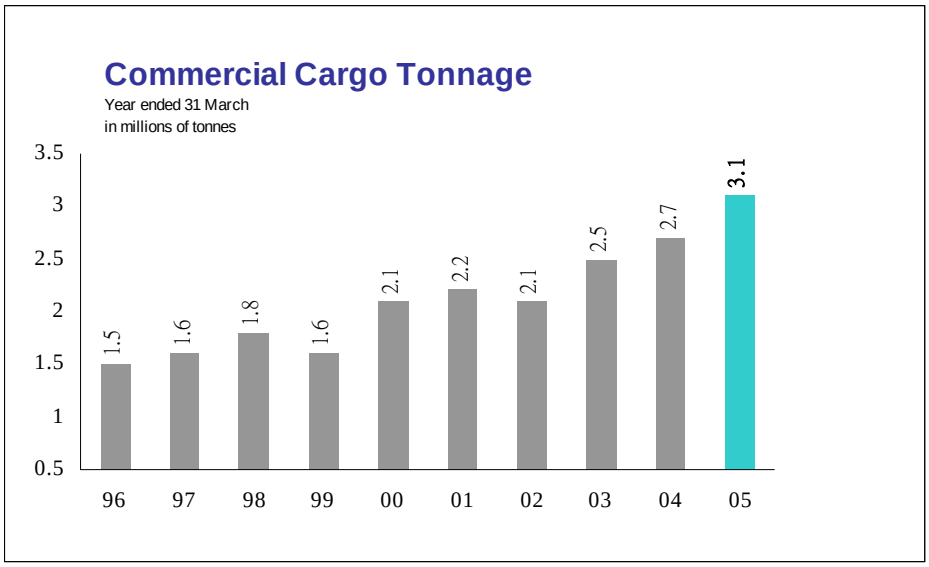
Passengers and Cargo at HKIA

As mentioned above, the rise in passenger and cargo traffic was the primary driver in HKIA's increased turnover in the last financial year. What are the current key data concerning passengers and cargo?

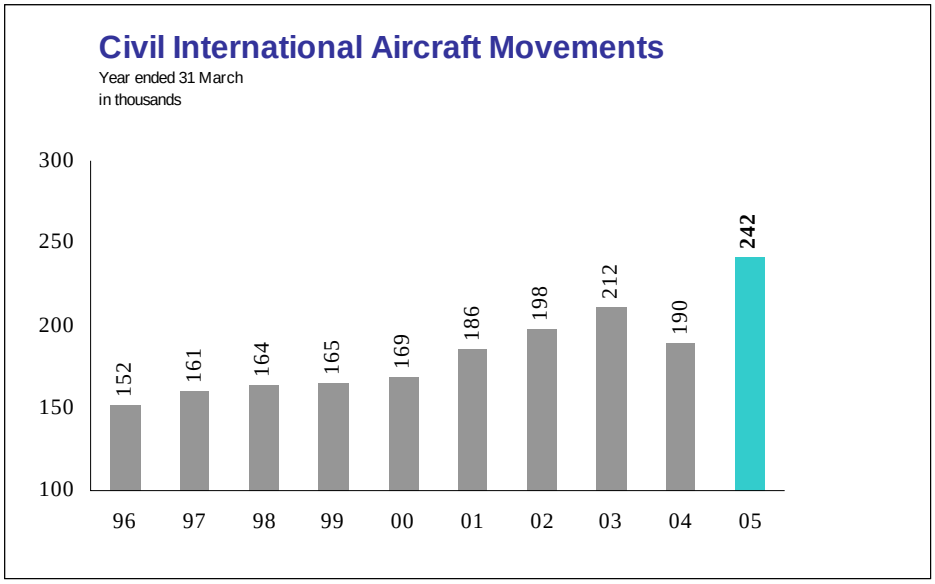
Total passenger movements at HKIA in the year ended March 31st 2005 exceeded 38 million trips. This was a significant improvement on the 27.7 million trips in the previous year, a depressed level that reflected the significant impact of SARS. In the three years prior to SARS, passenger volume was steady at between 33 million and 34 million trips each year.



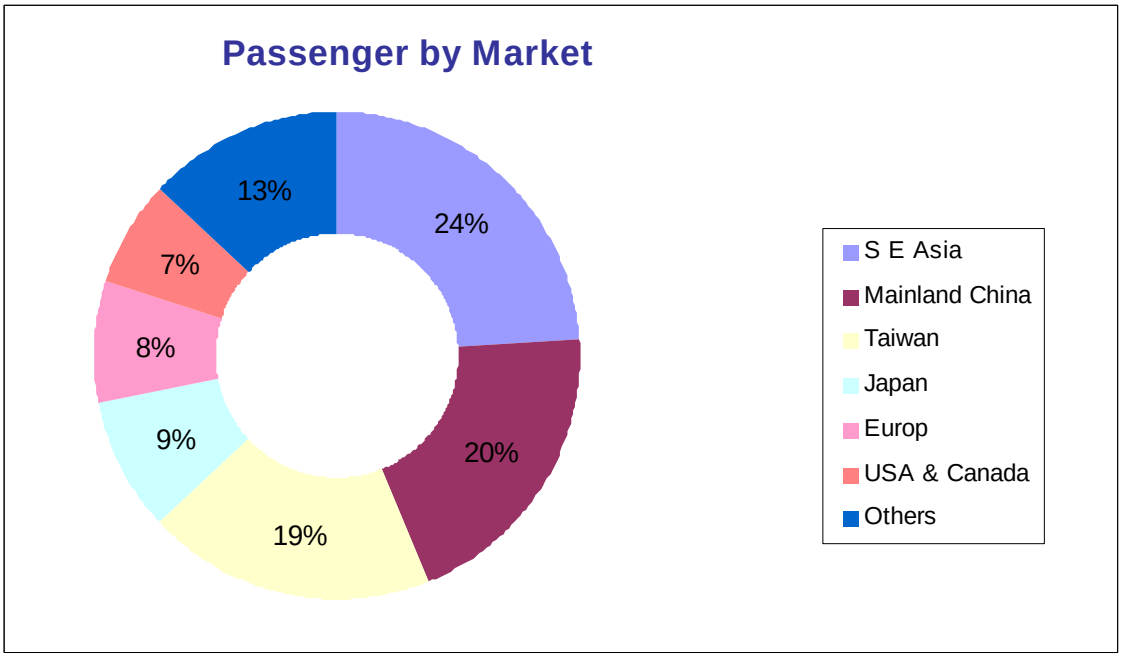
Cargo tonnage has also performed well. Dipping from 2.2 million tonnes in 2001/02 to 2.1 million tonnes in 2002/03, cargo has climbed steadily ever since reaching 2.5 million tonnes in 2003/04 and 2.7 million tonnes the following year. In the 2004/05 financial year, cargo tonnage reached a record 3.1 million tonnes. HKIA has been the world's busiest international air cargo hub for nine consecutive years. The Pearl River Delta is vital to HKIA's cargo business, accounting for 70% of all air cargo handled at the airport. HKIA handled some 1.8 million tonnes of PRD air cargo in the last financial year.



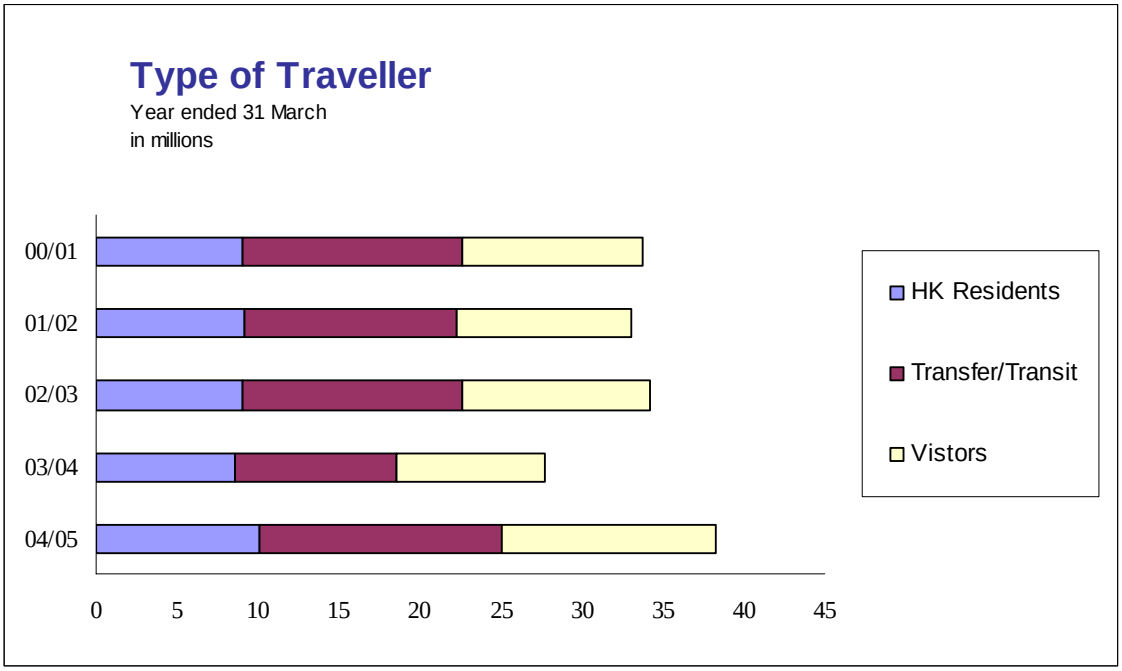
Air Traffic Movements rose to 242,000, representing a growth of 27% and 14% over 2003/04 and 2002/03 respectively.



Passengers using HKIA are from a variety of markets, with SE Asia accounting for 24% and Mainland China a further 20%. Taiwan contributes 19%. Much of the remaining 37% are drawn from Japan, Europe and North America.



In terms of the type of traveler using HKIA, visitors make up the lion's share at 15 million, with Hong Kong residents accounting for 10.1 million and transfer/transit adding a further 13.2 million. Some 15 million people travel to and from China via HKIA each year.



HKIA's Operating Philosophy

An interesting feature of HKIA's employee profile is that there are 12,000 people working at the airport but only 900 directly employed by the AA. This is because the AA contracts out most of its services. The core in-house competency includes maintenance of runways, runway lighting, the flight information system, the operations centre (controlling the terminal building and its facilities), a maintenance management team, cleaning and security. The AA's workforce is built around an extended team of managers that co-ordinate the work of contractors.

Two key examples of HKIA franchises are in the fields of cargo and catering. HKIA has two cargo franchises which are currently with Hactl and AA. These are Build-Operate-Transfer facilities that will revert to the AA's ownership after 20 years. Each of the franchisees pays the AA a minimum rent or a percentage of turnover – whichever is higher. In catering there are three franchisees: Lufthansa, Cathay Pacific and Gate Gourmet. These operate in a similar manner to the cargo franchises.

This policy yields major benefits to the AA with franchisees competing on service and price so that users benefit from the competition. For the AA, there is limited downside and maximum upside.

HKIA Is Now Facing Growing Competition

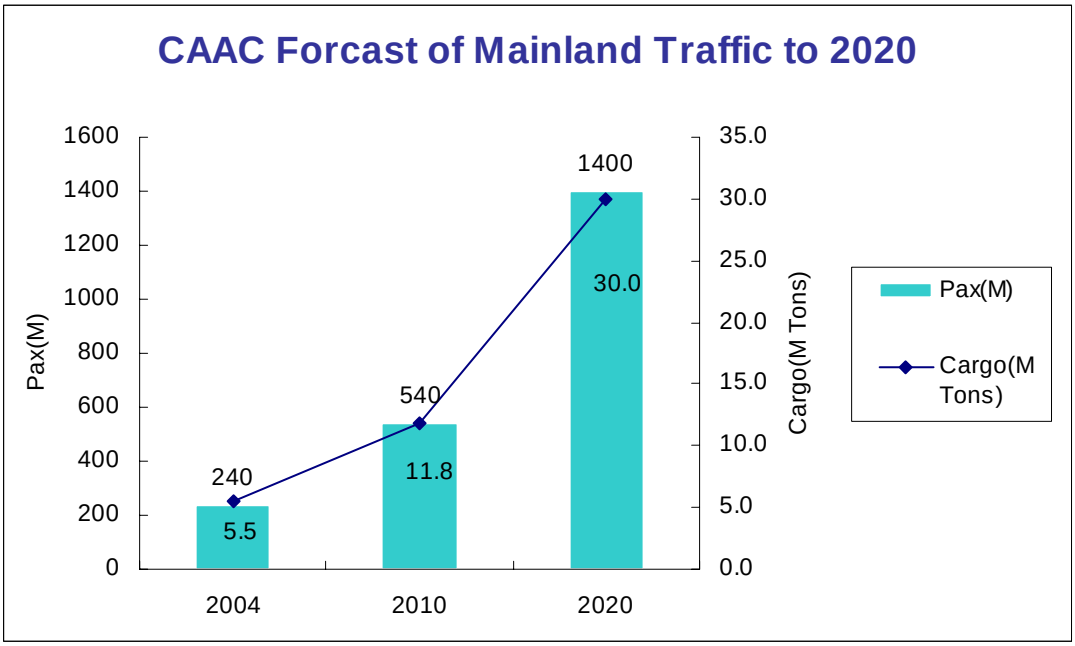
As we have already seen, the 2004/05 financial year was a record for HKIA, with awards from Skytrax and AETRA confirming once again that Hong Kong is blessed with the world's best airport.

But it is clear HKIA cannot afford to rest on its laurels.

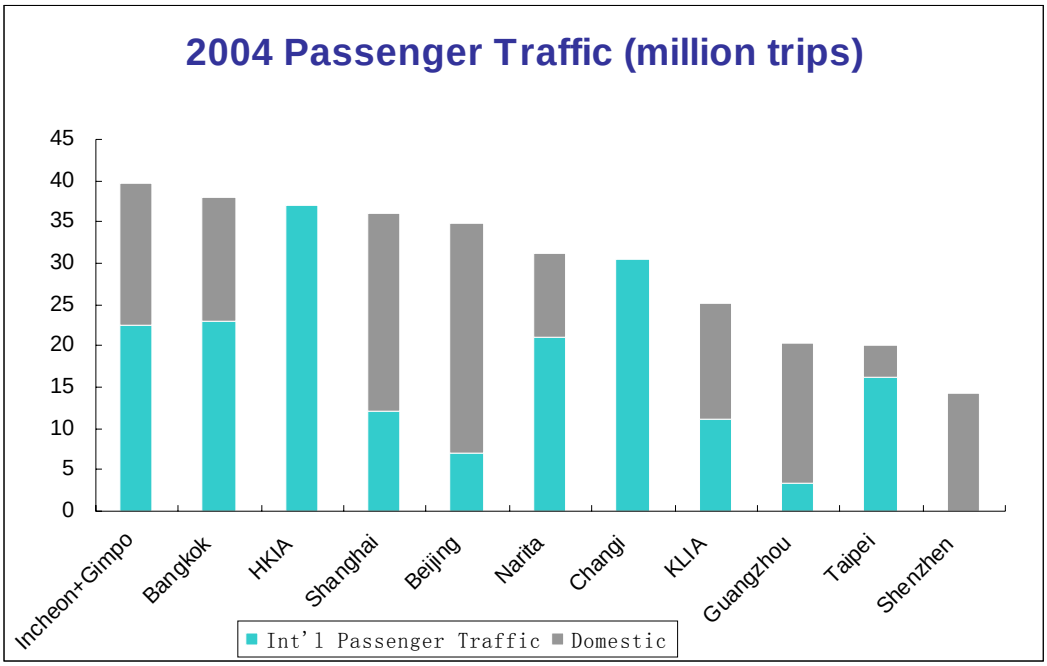
The first point to make is that Hong Kong's "Gateway to China" status is under threat. China's airports are developing quickly. More and more direct services into China are bypassing Hong Kong. In recent years, Mainland airports have been aggressively developing international traffic on the back of increasingly liberal air service agreements. These include Beijing, Shanghai and Guangzhou, as well as Shenzhen – a traditionally domestic airport. Regional hub airports like Singapore Changi, Bangkok, Narita and Incheon are targeting the high-growth Mainland market. International direct links from key US and European airports to the Mainland's hubs and secondary airports are increasing. These developments could potentially erode HKIA's traditional role as the gateway to the Mainland. The regional competition may also impact HKIA's status as a transfer hub.

The possibility of direct flights between the Chinese mainland and Taiwan will also have an impact on Hong Kong. If this happens, it will affect the share of transfer passengers currently passing through Hong Kong from Taiwan.

There is also the question of Hong Kong's size as a market. The fact is it is a small market of less than 7 million people and with limited growth potential. Mainland China, in contrast, has enormous potential as an aviation market. The CAAC (Civil Aviation Administration of China) has forecast that Mainland traffic will reach 1.4 billion passengers and 30 million tonnes of cargo by 2020.



The growth in China is already evident in the way Shanghai and Beijing are catching up with HKIA in terms of passenger traffic. In 2002, HKIA record 34.3 million passenger trips with Beijing and Shanghai seeing 27.2 million and 25 million respectively. In 2004, HKIA had increased its passenger throughout to 37.1 million but Beijing and Shanghai had achieved far bigger jumps with 34.0 million and 36 million respectively.



The AA is fully aware of these competitive pressures. The HKIA Chairman, Dr Victor Fung Kwok-king, said in the latest HKIA annual report that:

"this is the time for us to have a good understanding of aviation trends and place a firm grip on the fast-changing market. The rapid de-regulation of air services, the increase in Low Fare Carriers and the increasing competition of the airport hubs in the region have produced significant changes in the competitive environment. The results for 2004/05 are good but they should not blind us to the fact that we must remain vigilant and proactively deal with competitive threats".

Competition and Collaboration

But competition also brings with it opportunities for co-operation. In the PRD, for example, HKIA's market and product overlaps with competitors with customers using different airports to meet different requirements. Hong Kong people go to Shenzhen for cheaper flights to Shanghai and Beijing, whereas outbound PRC citizens use Hong Kong for its international connectivity. There are clearly competitive dynamics as well as synergy. There is a strong argument for HKIA acting as a strengthening and unifying force for airports and airlines in China. HKIA can both compete and co-operate at the same time.

The PRD alone underlines the needs that Hong Kong can serve. With a population of 25 million people with a per capita income of between US$3,000 and US$5,000, it is the richest part of China. It is also on the verge of explosive growth regarding its propensity to travel.

Co-operation with neighboring airports is based on a vision of the airports combining their strengths to become one of the leading airport systems in the world capable of serving large volumes of passenger and cargo flows.

Look at Hong Kong and Shenzhen, for example, with passenger flows of approximately 38 million and 15 million respectively in the past year. If Hong Kong and Shenzhen could combine into 1 airport system with seamless transfer, the combined market would be some 53 million passengers annually.

HKIA's New Competition Strategy

The AA is fully aware of the growth of competition and is taking comprehensive steps by redefining its business, its market and its product. The AA is repositioning HKIA as the centre of integrated multi-modal flows of people, goods, information and capital. It believes that in order to compete it needs to reach out to the source of flow, to understand the market and to find solutions that meet customer needs. The AA now sees the whole of China as its home market.

The AA's Finance Director, Mr. Raymond Lai, recently said: "Our market is no longer just Hong Kong – it is too small. Our immediate market is the PRD and our wider market is literally the whole of China."

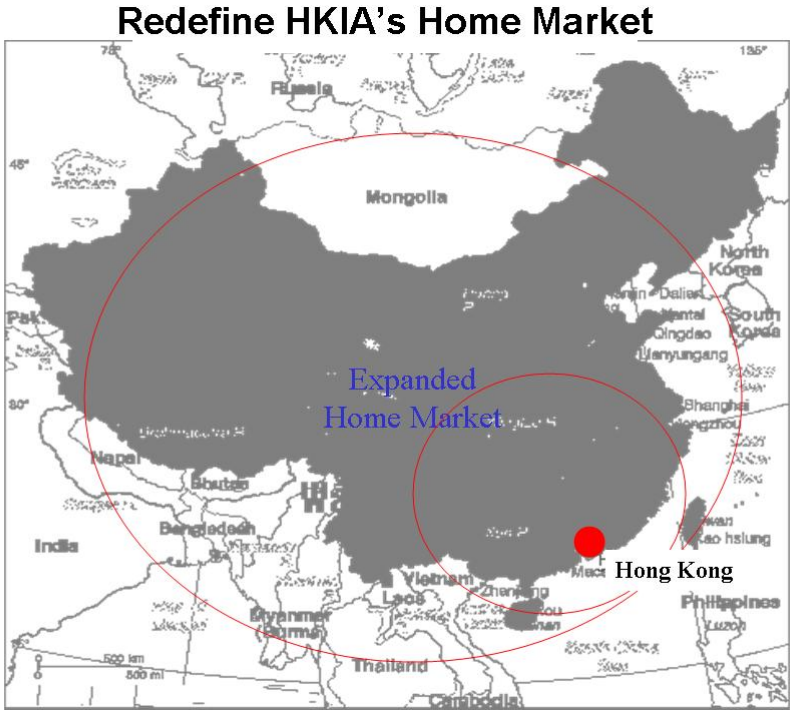
Redefining HKIA's product has called for a recognition that the airport business itself is in transformation. Airports are no longer seen as pieces of passive infrastructure enjoying monopolies. They are now taking on the mantle of commercially run service businesses that seek to offer a unique customer experience.

The AA's Raymond Lai has said of this: "We are not an infrastructure business. We have transformed into a service business. But service is only a part of it. What we are ultimately selling is a unique airport experience, comprising efficiency, security, safety and an overall ambience of comfort. Our airport is more than a place where your aircraft takes off."

The HKIA describes its current business strategies as involving continuous transformation through process management of "Excellent Health, Sustainable Growth and Innovative People". Its focus on "health" describes the ongoing development of efficiency and customer service. The "growth" component is seeking to enhance connectivity to the PRD and beyond to embrace the entire Chinese Mainland. The work on "people" underlines the AA's awareness that securing, developing and retaining a high level of talent is integral to HKIA's future.



"We are connecting our home market of China with the world," Mr. Lai said recently. "Our strategy is very much from the perspective of all China – China is much more than just the PRD. China has many economic regions similar to the PRD."



HKIA is looking at its future very much in the context of China, seeing itself as an integral part of China's aviation world and seeking to contribute substantially to the overall development of China's aviation sector. China's accession to the World Trade Organization (WTO) was a key development in this regard. The AA firmly believes its airport can take centrestage in the process of integration between China and the global economy.

How will the AA realize its new strategies? The 10 Key Projects that will underwrite HKIA's development through 2010 provide a comprehensive tactical plan. This program includes enhancement of terminal facilities and services, as well as enhancement of apron parking and hangar capacity. It incorporates initiatives that will strengthen flow of passengers and cargo. The 10 Key Projects also address the need to integrate more closely with the PRD and other Mainland airports. Development of SkyCity – including SkyPlaza and AsiaWorld-Expo – are also on the agenda, as are the issues of privatization and career development.

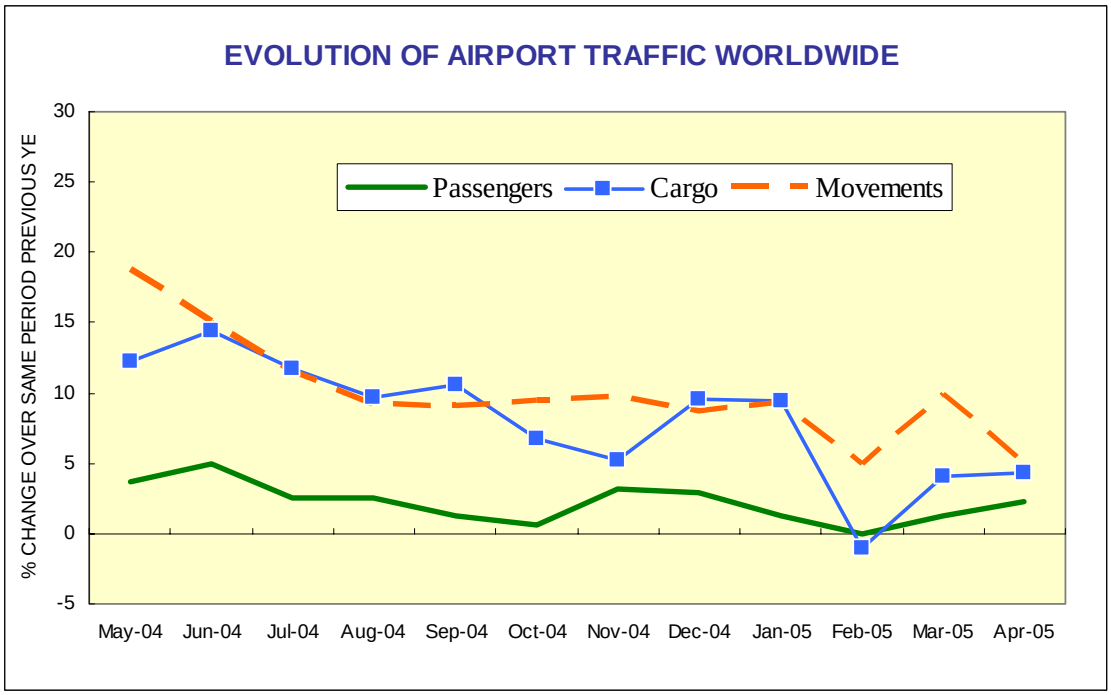
A Busy Future Beckons

HKIA is no stranger to growth. Since HKIA's opening in 1998, it has continuously upgraded its facilities and provided many new services. All this is enhancing competitiveness and paving the way for future business growth.
Now HKIA's overall aim is to aggressively enhance HKIA as a major international and regional aviation hub and gateway into China. It will do this by expanding the existing air network and linking the airport with a greater number of destinations and increased frequencies to major world centers and with more cities on the Mainland. HKIA's strategy for sustainable growth is to maximize the "push and pull through" of passenger and cargo flows into the airport. This means improving connections with its target markets, particularly in the PRD.

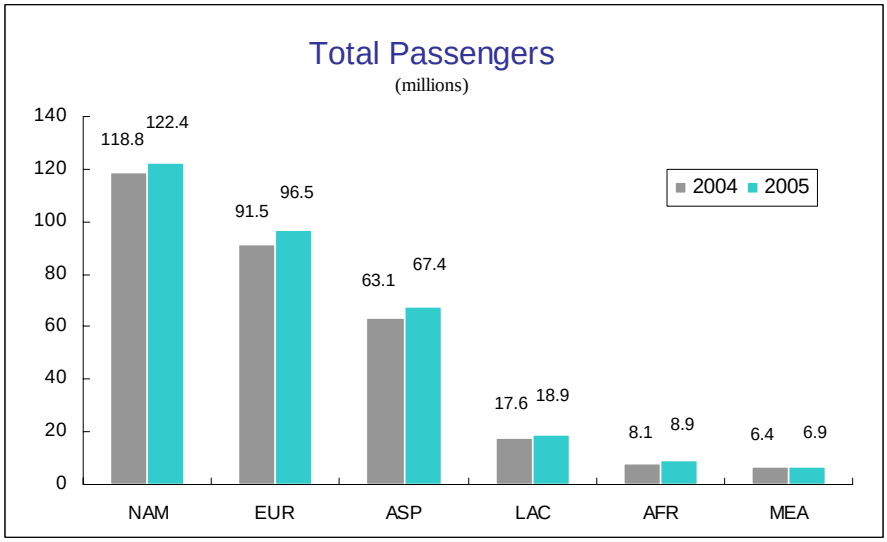
HKIA is confident it will be able to use the airport's ultimate design capacity of 87 million passengers and 9 million tones of cargo annually. Development options include construction of an additional passenger terminal and associated concourses, maximizing and expanding cargo facilities on the apron and in cargo processing areas, and development of business and commercial facilities that complement the core airport business.

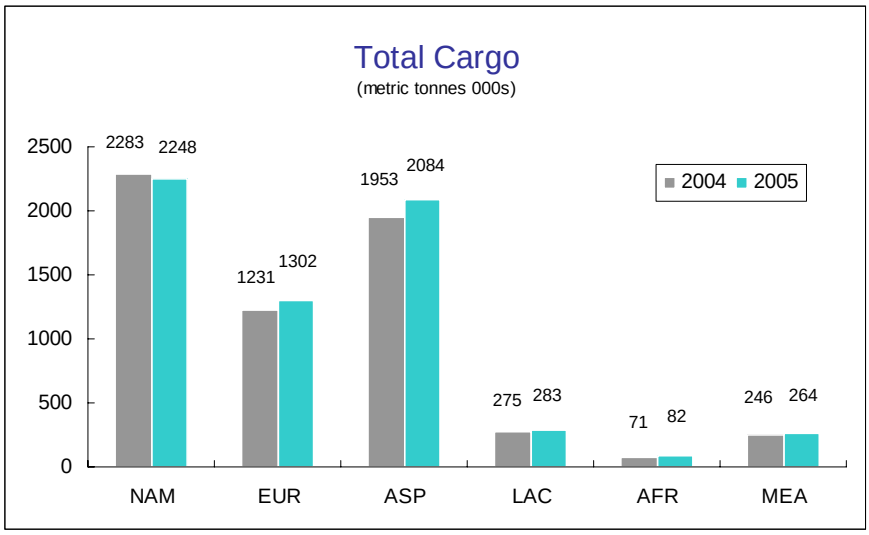
Conditions for growth are good

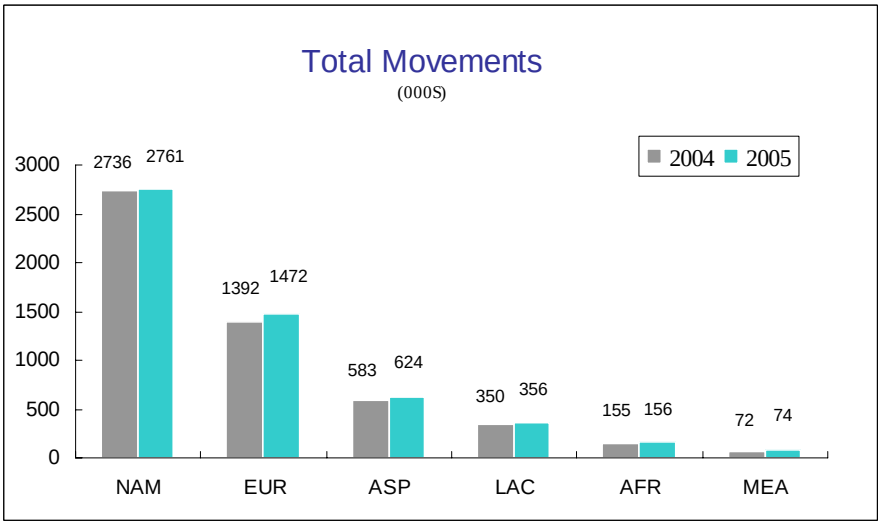
The aviation industry is growing in both qualitative and quantitative terms, with newer, larger and faster aircraft being developed. Airports and the aviation industry have become important engines of economic growth.



Recent data certainly underlines quantitative improvements following the SARs crisis that had a worldwide impact.







A report by Airports Council International published in July 2005 presents data from over 830 airports worldwide for the month of April 2005 that shows passenger traffic rising 5%, cargo 3% and movements 3% compared to April 2004. On the basis of the whole year ending April 2005, the growth in passengers was over 9%, while cargo was over 7% and movements were over 2%.

The geographic breakdown across six key regions – North America, Europe, Asia Pacific, Latin America and Caribbean, Africa, Middle East – shows that all areas experienced growth in the month of April 2005 over the same month in 2004 for passengers, cargo and movements.

The potential for China in particular is very strong. China's focus on aviation is pronounced with the government having marked the industry as one of the key development sectors nationally. This will stimulate both passenger travel and air cargo. Government policies have increased the number of Mainlanders eligible for travel into Hong Kong. The Closer Economic Partnership Agreement (CEPA) is another catalyst for growth in cross-border activity. This allows access for Hong Kong companies and service providers to the Mainland market ahead of China's WTO timetable. Furthermore, China has moved to a policy of rapid liberalization of the air services regulatory environment. With the Mainland's GDP and consumer disposable income still rising rapidly, demand for air transport for passengers and cargo is set to grow.

Passenger Initiatives Take Off

Data from ACI (Airports Council International) shows that passenger levels are seeing strong growth. More to the point, Asia Pacific is enjoying better growth than other parts of the world. Asia Pacific saw 19% more passengers for the year ending October 2004, against a global figure of just 10.7%.

ACI Stats Regions	ACI Pax Flash 12 Month Ending October 2004/2003 for the major world airports					
	Intl. PAX	% Chg	Dom. PAX	% Chg	Tot. PAX	% chg
AFR	18,832	13.3%	17,795	9.1%	37,180	10.0%
ASP	224,617	25.1%	229,792	13.7%	466,037	**19.0%**
EUR	547,782	8.4%	165,714	3.0%	718,352	7.1%
LAC	30,856	12.8%	39,849	15.2%	73,128	13.7%
MEA	40,578	19.3%	386	(5.7%)	42,516	18.2%
NAM	117,550	12.8%	547,320	8.9%	807,743	9.0%
Total	**980,215**	**13.0**	**1,000,856**	**9.2**	**2,144,956**	**10.7**

HKIA certainly sees many opportunities in the context of passengers and its Master Plan includes expansion of passenger facilities as well as additional aircraft parking to ensure the airport can maintain the present high rate of airbridge embarkation and disembarkation.

The past year was a busy one in terms of new initiatives for HKIA's passenger-related operations. The achievements reflect the AA's strategic focus on "Sustainable Growth", with initiatives that are supporting the objective of enhancing connectivity to the PRD and throughout the Chinese Mainland.



A new Coach Station for Mainland passengers was opened in 2003. Located on ground level at the northern end of the Arrivals Hall, the Coach Station has sheltered bays for 10 coaches. A variety of cross-border operators now offer up to 220 services a day to destinations throughout the PRD and beyond. This is evidence of the AA's policy to build new "multi-modal" transport links to the PRD as part of the wider initiative to increase connectivity to this important part of HKIA's extended marketplace.

Far more important is the new cross-boundary ferry terminal called SkyPier that opened in September 2003. Offering high-speed ferries to HKIA from ports in the PRD, this is an excellent example of how the AA is seeking to achieve seamless border crossings in relation to China. Travelers arriving at SkyPier now proceed to the passenger terminal by bonded buses for their flights without having to go through Hong Kong Immigration and Customs formalities. SkyPier is clearly offering convenient access to HKIA's expanded home market in the PRD in line with its stated strategic focus. The AA announced two new SkyPier ferry berths in November 2004 catering for extra traffic passengers using the SkyPier cross-border ferry and usage of the cross-border coaches increased by 77%.



How SkyCity Will Boost Passenger Numbers

SkyCity is an enormously important development for HKIA and will have a major beneficial impact on passenger flows. This "mega development" on a 57-hectare site located on the east side of the Passenger Terminal Building (Terminal One) will boost HKIA's retail business significantly. When completed, SkyCity will comprise SkyPlaza (the airport's second terminal with a multi-purpose retail, catering and entertainment centre) and AsiaWorld-Expo (a huge new international exhibition centre that will also bring customers to new and existing retail outlets). SkyCity will also include a golf course, a hotel and an office tower. This entire complex is one of the 10 key growth projects that will strengthen HKIA's competitive advantage. The SkyPlaza retail, catering and entertainment component started construction in 2003.



More Work Underway On Cross Border Issues

The AA's continuing focus on cross-border issues for passengers reflects the strategy of building a market beyond Hong Kong as a way of dealing with competitive pressures. For example, the Authority has been pursuing the possibility of a dedicated remote check-in facility at Shenzhen for land-air passengers. The objective is to check-in passengers before they enter the Hong Kong SAR boundary so that they will not have to carry baggage or go through control formalities when transiting the territory. Passengers will then be able to transit from Shenzhen to Hong Kong in the same way that passengers transit within any international airport.

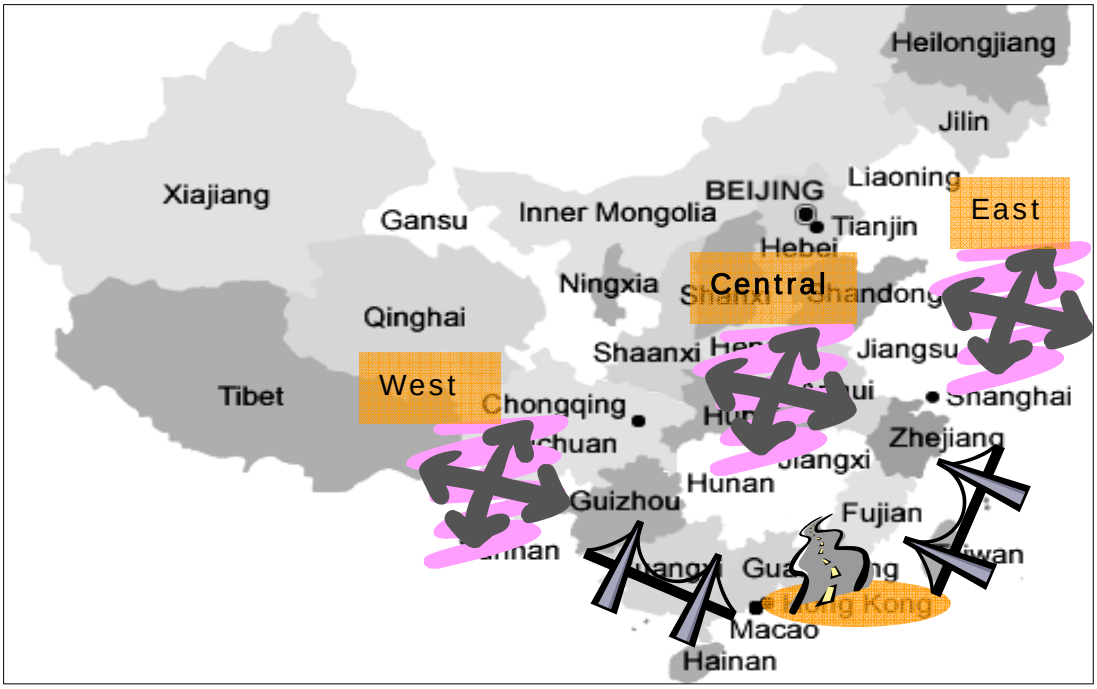
In addition to the Shenzhen remote check-in, the Authority plans for air passengers traveling in and out of PRD ports – including Shekou, Fuyong, Dongguan, Macau and Zhonghsan – to be relieved of carrying their baggage through various checkpoints and to receive a "guaranteed acceptance of carriage" by the air carriers before arriving at HKIA. To deliver this service, the Authority formed a ground handling service in 2004 with two local airlines.

This move to cross-border integration is expected to go even further. The AA is examining the best way to implement a pre-clearance facility to allow incoming foreign travelers to complete Mainland entry formalities at HKIA, thus allowing onward travel to Mainland cities that do not have customs entry facilities.

Airbridges Extend HKIA's China Reach

HKIA is now reaching out even further than the PRD. It sees medium-term and long-term opportunities in tapping into fast-growing traffic flows from the inner regions of the Mainland. The key here is the "Airbridge" concept that is relevant in terms of both passengers and cargo. The HKIA believes that building Airbridges between Hong Kong and the Mainland is the right way to attract new sources of flow to HKIA of both people and goods, and to increase economic activity between two given regions. Airbridges will allow travelers to go to a city centre in the PRC and check in for domestic and international flights. Airbridges are envisaged with west China (where Kunming will be the focus), with central China (using Chongqing, Chengdu and Wuhan as the pivotal points), and with east China (where Shanghai or Hangzhou will be the focus).

To facilitate the development of Airbridges, HKIA is seeking to form strategic alliances with selected Mainland airports. HKIA's aim is to deploy its airport management expertise and nurture strategic partnerships. It has recently provided airport consultancy studies to Shanghai Pudong International Airport and Beijing Capital International Airport. These have provided for a more long-term business co-operation with the Mainland. In April 2005, HKIA signed an agreement to acquire Hangzhou Xiaoshan International Airport, a move that marked another milestone in HKIA's strategy to grow its revenues and become actively engaged in the development of the Mainland's aviation sector.



Hangzhou illustrates the Airbridge concept well. Before the acquisition, Hangzhou ran just four flights a day. With HKIA's involvement, this was increased to five through existing carriers and then the addition of flights by Air China and Hongkong Express took the daily flight total up to nine. The AA has been the clear catalyst for adding more airlines and more frequencies to an airport to strengthen the "Airbridge" to the benefit of both Hangzhou and Hong Kong. The key point is that by being an investor in satellite airports, the AA has greater leverage in terms of persuading airlines either to take up new airports or to add frequencies at airports they currently serve.

The inclusion of airport management services in CEPA II is important as it allows HKIA to participate in the modernization of airport management on the Mainland.

LFCs

Airports around the world are responding to low-fare carriers (LFCs) as a new market segment and, now that the low-fare phenomenon has reached Asia, the HKIA is no exception. HKIA is actively encouraging LFCs to use the airport. HKIA believes this new segment of passengers and their carriers represent a core part of the future growth of traffic flow at HKIA. As regional air service agreements become progressively more liberalized, the potential LFC market will expand even more rapidly. This will stimulate demand by creating new markets and offering passengers competitive pricing.

How HKIA Will Build its Retail Operations

The start of construction work on SkyPlaza – part of the wider SkyCity project – underlines the importance of retail business to HKIA. Given that passengers are the

ultimate end-users of any retail outlet – whether providing food, fashion or entertainment – HKIA's retail business base can be seen as a sub-set of its passenger operations. Any expansion of HKIA's retail business certainly depends on drawing an increased number of passengers.



SkyPlaza will benefit significantly from the Hong Kong-Macau-Zhuhai bridge when it is completed. The bridge will make its first point of entry into Hong Kong beneath SkyPlaza. As a result, it will feed PRD-based travelers flying overseas (who will arrive in Hong Kong by bus via the bridge) directly into the retail complex.

Developments such as SkyPlaza will help to stimulate a greater propensity to spend at the airport rather than in alternative retail districts such as Central, Tsim Sha Tsui or Causeway Bay. But the very fact that passengers buy into the concept of buying retail goods or services at an airport underlines just how much airports themselves have changed.

Retail is an important business issue as there has been a trend worldwide in recent years for the proportion of airports' non-aeronautical revenues to rise worldwide. It is estimated that some 30% of airport revenues came from this source in 1990. By 2001, it is believed this figure had increased to over 53%. The increase in non-aeronautical revenues during recent years has been one of the most important trends in airport economics and planners are taking note of this fact. This growth in non-aeronautical income is evidence of the entrepreneurial creativity of airport operators as well as the growing emphasis placed on customer service. It validates the philosophy that an airport should provide not only air services but also shopping and entertainment opportunities.

The importance of retail at airports goes further. Retail is not just an additional source of revenue; it is also provides an income stream that helps airports cope with expensive new security arrangements. Those airports with diversified income streams, apart from traditional sources based on user charges, tend to ride out slumps better than their peers. Retail strategy is an integral part of any airport's growth strategy.

Opportunity Knocks: the Growing Importance of Cargo

However the future shapes up, one thing is clear: air cargo will be a key component. HKIA's cargo achievements have long been recognized. A highlight was the award of "Cargo Airport of the Year 2002" by the London-based industry magazine, Air Cargo News.

Air cargo has steadily become more and more important to HKIA and to Hong Kong as a whole. The share of air cargo within Hong Kong's overall external trade grew from 26.7% five years ago to 32.4% in 2004. This is largely due to Hong Kong's ability to react to the shorter response time demanded by trade buyers for delivering exports, complemented by Hong Kong's efficient air transport services, an extensive global air network and world-class logistics supply chain management.

Even more important is the role cargo business plays in boosting not just aeronautical revenues, which are based largely on weight, but also in maximizing the use of scarce airport capacity. The key here is that many cargo operators and express package integrators schedule the bulk of their flights in the late night/early morning period. Cargo operations therefore often occur outside peak hours for passenger traffic. An increase in cargo volumes represents an opportunity for better utilization of an airport's expense asset base, with its associated high fixed costs.

The world of industry will provide a long-term and robust demand for air cargo. It already accounts for some 40% of world trade in value terms. As sophisticated just-in-time global manufacturing processes call for global supply chains to become faster and even more efficient, the speed of air cargo will more and more become the transport mode of choice.

Data from ACI (Airports Council International) shows that the growth in cargo volumes is already evident, especially in the Asia Pacific. Cargo measured in metric tones in 2003 was higher by 2.8% on a global basis but Asia Pacific alone enjoyed a differential of 5.6% over the previous year.

Air cargo trends by region (2002-2003)

Region	Cargo-metric tones 2003(million)	% change (from 2002)
Africa/Middle East	4.03	4.0%
Asia/pacific	20.94	**5.6%**
Europe	14.05	2.3%
Latin America/Caribbean	2.94	(-1.4%)
North America	26.67	0.9%
Total	**68.63**	**2.8%**

In terms of cargo, HKIA's vision is for logistics facilities to complement the further development of Hong Kong as an international trade centre and logistics hub. HKIA continues to focus on speeding up the time it takes for goods to move from their source in the PRD to stores in markets such as the US. Business partners at the airport have assisted with growth of the cargo business by promoting the development of inter-modal transport. For example, Hactl and AAT have each launched China direct services using sealed trucks from Hong Kong to cities on the Chinese mainland. These services offer simplified customs clearance, obviating the need for further customs clearance at the boundary. The service brings the benefits of HKIA's cargo network closer to manufacturers over the boundary.

Other developments in cargo include the construction of Tradeport Hong Kong to develop a logistics centre at the airport for processing time-critical cargo. In 2001 a Marine Cargo Terminal opened to link the airport with 20 river ports in the Pearl River Delta. Planning for the future includes off-airport logistics parks on North Lantau.

Recent Achievements in Cargo

The HKIA has been working with its business partners to reinforce its position as the number one air cargo hub in Asia. Much has been achieved and HKIA is confident it will capture more business. The record of progress in cargo in the past year is impressive.



HKIA awarded a franchise to DHL to build the largest express cargo terminal of its kind in Asia, with the US$100 million facility commencing operations in the middle of 2004. DHL has in turn strengthened its intra-Asia network with Air Hong Kong by providing over 80 services per week to nine destinations.

HKIA also reached agreement with Asia Airfreight Terminal (AAT) to triple its capacity to meet the substantial growth of cargo business in future years. The new multi-level air cargo terminal, costing HK$1.75 billion, will be operational by the end of 2006.

Another major initiative and one that contributes to the bid to achieve seamless border crossings for cargo (and passengers) is the opening of the first Air Cargo Consolidation Centre (ACCC) in the PRD. Located at the Shenzhen Futian Free Trade Zone, this is a joint effort between HKIA and Hactl. The Authority is exploring the feasibility of setting up additional ACCCs at strategic locations in the PRD. The significance of the ACCCs is that consolidators and shippers don't have to deliver to the doorstep of HKIA anymore. They can deliver to the consolidation centers in Mainland China. The AA plans to build up to 7 ACCCs in the PRD. The ACCCs in the world of cargo should be seen in the

same context as upstream check-in for passengers at PRD ferry ports and at locations in Mainland China offering coach links into Hong Kong. These initiatives each enhance flow and create a seamless border. The Airbridges concept complements upstream check-in for passengers and the ACCCs for cargo, by enhancing flow of passengers and cargo from regions beyond the PRD and deeper in Mainland China.

There were many other moves in cargo during the year. Hactl extended its SuperLink China Direct chartered truck service to cover 57 destinations in the PRD, offering enhanced door-to-door connectivity for freight forwarders and their customers. Hactl also opened its Downtown Terminal and Livestock Handling Centre in November and December 2004, respectively, to provide general cargo acceptance at an off-airport location as well as dedicated handling services for large livestock.

Another initiative enhancing connectivity was AAT's launch in February 2005 of its New Cargo Management System to provide a fully integrated one-stop-shop computerized system for its customers. In April 2005, HKIA hosted the first Hong Kong Air Cargo Forum, sharing development plans and competition strategy with its air cargo partners. The Marine Cargo Terminal (MCT) continued to thrive. This is a critical component in the overall supply chain and the provision of inter-model services. It handled 40% more cargo during the latest financial year than the year before. The MCT is also enhancing its services to the West Bank of the PRD. A new marine link has been established for delivering perishable goods between HKIA and Shekou.

HKIA is also seeking to build a Logistics Park in Tung Chung, adjacent to HKIA. The AA does not have sufficient space within the boundary of the airport itself to build this facility and has sought approval from the Hong Kong Government to undertake this project. The Government has indicated it would prefer to build the Logistics Park itself and the AA has therefore not received any confirmation for the project so far.

How Will HKIA Steer a Successful Path into the Future?

It comes as no surprise that there are growth opportunities in passengers, in retail and in cargo. But the key to the future is to ensure that all players in the PRD and further afield in China see growth. Collaboration is a critical success factor. There's little benefit in a zero-sum game in which HKIA thrives while neighboring airports complain about "lost" business. Is there a danger of this happening?

Look at the work HKIA is doing in terms of dealing with the "artificial barrier" of the border between the Hong Kong SAR and the Mainland. Does seamless transfer help only travelers? Or do neighboring airports benefit too? What further passenger and cargo initiatives will help to bring about the vision of "airports combining their strengths to become one of the leading airport systems in the world, capable of serving large volumes of passengers and cargo". What can HKIA and its neighbors in the PRD and elsewhere on the Mainland do to truly bring this collaborative concept to life? Surely this is where HKIA and neighboring airports should spend most effort if the zero-sum game is to be avoided.

Examine HKIA's critical success factors and analyze how it can transfer some of its expertise and knowledge to the Mainland. Look at the case of Hangzhou Xiaoshan International Airport, where HKIA is ushering in the Airbridge concept. In no time at all it has increased Hangzhou's daily flight total from four up to nine. The AA has been the clear catalyst for adding more airlines and more frequencies to an airport deep inside Mainland China to strengthen the "Airbridge" to the benefit of both Hangzhou and Hong Kong. So should the AA invest in other "satellite" airports? Which ones? How best to leverage such investments? And how should HKIA adapt its marketing to international carriers now that it is clearly on the acquisition trail?

Think of the success HKIA has achieved in the retail sphere too, becoming a clear example of the trend in which airports take on the mantle of commercially run service businesses. Should HKIA provide greater leadership in this respect? The major extension to HKIA's East Hall dramatically benefited terminal commercial revenues in the 2004/05 financial year – chalking up a retail sales record with a 60% increase over the previous year, including retail license income recording growth of 46% and 24% compared to the previous two years. The increase was largely attributed to the East Hall extension. The retail story has not ended; SkyPlaza is another exciting installment. Are airports in the PRD learning from this? Can HKIA actively help them build business by developing retail operations? Should retail be a focus at Hangzhou, for example?

And look at the wider infrastructure picture. SkyPlaza is part of the wider SkyCity project that includes the AsiaWorld-Expo international exhibition centre – all linking with the new Hong Kong-Macau-Zhuhai-Bridge. This is an excellent example of investment that benefits not only HKIA. What other opportunities exist in terms of new infrastructure, either in Hong Kong or on the Mainland?

HKIA's fortunes are inextricably entwined with the broader story of Hong Kong's re-integration into China. The world will be watching HKIA with interest and anticipation. The story of HKIA is an exciting one. The first chapter is complete; what will the next chapter bring?

Privatization of Hong Kong's Airport

In Hong Kong's official budget for 2004, Hong Kong's Financial Secretary announced, "We will shortly introduce into this Council an amendment bill to effect capital restructuring of the Airport Authority…. if the required legislative processes can be completed next year, we hope to implement the airport privatization…in 2005-06." The government had separately announced that the privatization of the airport would take the form of an initial public offering.

Mindful of the many concerns raised by the privatization process, the Airport Authority (AA) noted in its Annual Report for 2003-04 that its overall objective would be "to achieve a balanced regulatory framework which takes full account of the public interest and also allows for the growth and development of HKIA." The privatized entity was expected to "institutionalize market discipline and supervision in the running of the airport for greater efficiency while maintaining high service standards and ample capacity for growth: (Annual Report 2004-05). Privatization would also help AA to gain easier access to the capital markets for expansion funding.

The Winds of Change: Privatization as a Trend

Prior to the 1980s, governments across the world had been the major source of funding for and owners of large infrastructure projects, such as highways, dams, airports and mass transportation projects. In the United States, the federal government also conducted research in government laboratories and supported, through grants to states, education and additional infrastructure projects. In Western Europe and Latin America, governments had nationalized many industries, including the energy-producing sectors, telecommunications and health care systems. In the Eastern Bloc, the Soviet Union and other communist regimes, governments sought to do away with the private sector altogether.

Then, in the 1980s, the trend shifted away from public sector ownership to privatizing government entities and activities across the world. Governments sought to unload their assets and services and to enlist private sector involvement. By the 1990s, privatization was a global economic phenomenon. In 1990, for instance, governments had made $25 billion off of sales of government utilities and state-owned enterprises.

The proponents of privatization argued that privatization of government assets and activities would lead to many significant improvements, including increasing the quality of the remaining government activities, reducing taxes, and shrinking the size of government. Moreover, the privatized entities, now run with the profit-seeking motive, would be more efficient, would cut costs and would give greater attention to customer satisfaction.

Others were more cautious about rampant privatization, arguing that there was not always a direct correlation between private ownership and improved efficiency. They also warned that with the incentive of profits, a private company could price essential services beyond the reach of the general population. The issue for those cautious about privatization was more pragmatic than ideological. It was about managerial behavior and accountability. They codified the debate about privatization into three conclusions:

1. Neither public nor private managers will always act in the best interests of their shareholders. Privatization will be effective only if private managers have incentives to act in the public interest, which includes, but is not limited to, efficiency.
2. Profits and the public interest overlap best when the privatized service or asset is in a competitive market. It takes competition from other companies to discipline managerial behavior
3. When these conditions are not met, continued governmental involvement will likely be necessary. The simple transfer of ownership from public to private hands will not necessarily reduce the cost or enhance the quality of services. (Goodman and Loveman, HBR, 1991).

The central issues of concern in any move to privatize boiled down to how private managers behaved and how they could be monitored and also if the market was competitive rather than monopolistic.

Privatization of Airports

The general global trend to privatize reached airports as well. By 2000, more than 100 airports in more than 30 countries had turned to the private sector for capital investments and management expertise. With an increase in air traffic at a pace of about five percent per year and many governments facing resource and budget constraints in the late twentieth and early twenty-first centuries, it appeared that airports would continue to be a focus of privatization activity.

In general, services at airports can be divided into “airside” and “landside” categories. Airside services include the runways, taxiways, aprons and terminals. Landside services include passenger check-in, retail and duty-free concessions, food and beverages, car parking, and hotels. The airside services have traditionally been built and funded by the government in large infrastructure projects and their continued operations are funded, at least in part, from landing fees, passenger fees, and profits from fuel, ground handling and aircraft catering activities. The landside services are usually financed in part by revenues from renting counter and office space to the airlines and from rents and fees charged to the retail, food and other businesses. By 2000, revenues from landside services accounted for at least half of overall airport revenues at many of the world’s largest airports.

Models of Airport Privatization

Privatization of airport services has not been only through direct sale of the government's assets. There have been several models used in privatizing part or all of airport operations. Traditionally, airports have been operated through government agencies. One way to involve the private sector has been to transfer agency operations to a government-owned corporation. This corporation, operating on a commercial basis, would have greater autonomy than a government agency and also greater access to private capital markets. Examples of government-owned corporations that operate airports are the Frankfurt Airport in Germany and Schipol Airport in the Netherlands.

Other models of "partial" privatization include build, operate and transfer (BOT) schemes, in which a private company fronts the initial investment in the infrastructure project and then is given the rights to operate the airport for a specified number of years before the operation is handed back to the government. In Bogotá, Columbia, this scheme was used for the construction of a second runway and also for capital improvements on the existing airport. In Toronto, a variation on BOT, BOOT (build, own, operate, transfer) was used to finance construction of a third terminal through a private developer.

In addition, governments have awarded management contracts to private firms to involve private-sector expertise in the management of airports. In such an arrangement, the government retains ownership of the asset but hands over management of the operation to a private firm. The government can also retain some control by setting performance standards. In 1998, Argentina awarded an extensive contract to a private firm to manage 33 of its airports for the next thirty years with an option for the contract to be extended for another ten years.

Why Privatize an Airport? The Pro and Con arguments

There were many reasons to privatize airports. These included increased ability for the airport to raise additional capital and seek new revenue sources from private markets, to improve efficiency, to reduce costs, to become more customer service oriented, and to increase competition among airlines to provide choice and cost reduction for passengers. In addition, the government could enjoy windfall revenues from the sale of its assets and could also collect taxes from the new private entity. The landside services, in particular, were services normally offered by private firms away from airports and their operations could easily be moved out from under government control.

While the idea of privatizing the landside services seemed a natural progression in the development of an airport, the privatizing of the airside services raised concerns from many sectors. Because many citizens in general saw the airport as part of a city's or region's essential infrastructure and also because airports were often regarded as important catalysts for local economic growth, the public at large believed that the

government should play an active role in developing and supervising airports. Moreover, because airside services were natural monopolies, the public often felt more comfortable and protected by keeping the government involved in airport regulation and supervision. In addition, many felt that the government had to be involved in ensuring safety and quality of service standards because of the inherent nature of air travel.

Not only the public, but also airlines themselves were generally concerned about privatization. They expected that without government involvement, privatization would bring higher landing fees and fuel prices, which would eventually translate into higher ticket prices for their customers.

Examples of Airport Privatization

Privatization of airports was not a new idea. In the late 1980s and early 1990s, the privatization model was being tested in places like Great Britain, Albany, New York, and Kerala, India.

British Airport Authority—market efficiencies through private ownership

In 1987, the British Airport Authority (BAA) was the first major airport privatization project in the world. BAA managed seven of Britain's airports, including London's Heathrow Airport. The authority floated shares in BAA on the London Stock Exchange in 1987 and earned US2.5 billion in its initial offering. Individual participation was limited to 15 percent and the government retained a single "golden share" through which it could exercise some control over some type of corporate decisions, such as the sale of the company or major acquisitions. By 2001, shares had appreciated in value to nearly five times their initial value.

Privatization of BAA led to marked changes in efficiency, corporate culture and incentives. Managers had thought their organization had been efficient before the stock sale, but market incentives led to company-wide improvements. BAA experimented with several financing schemes, including equity, preferred shares, bonds and long-term loans. The company diversified into a variety of related and non-related businesses, expanded retail operations at its airports (until retailing accounted for more than 50 percent of total revenues), and invested in real estate associated with the airports. It also began selling management and retailing services to other airports in such places as Mauritius, Newark, New Jersey and Pittsburgh, Pennsylvania.

Albany (New York) County Airport—raising capital through privatization

At the end of the 1980s, the county of Albany, New York, faced many financial problems and its airport was antiquated and inadequate. The county's executive looked to privatization of the county's airport as a means to solve the county's many problems. The financial problems would be solved both with the windfall from the sale of the asset and also because regulations had barred the county from using airport revenues for non-airport uses. This lack of incentive had made it a long-standing scenario that the

county's airport did nothing more than break even. The privatization of the airport would introduce market efficiencies and improve the service of the airport, officials argued. There would also be incentives for the private owner to improve the facilities and to shape the airport into a regional (and competitive) hub.

The county entertained offers from several organizations (both semi-private and private) and submitted proposals to the Federal Aviation Authority (FAA) for approval to sell the airport. While the FAA agreed in principle that the airport could be turned over to private interests, the issues raised by the proposals led to policy discussions that remained unresolved for more than three years.

In those three years, the federal government's Department of Transportation had changed its policy and would allow airports to collect passenger facility charges. Officials in Albany County could then see a means whereby the county could improve its own airport facilities without selling the airport through collection of these fees. It also realized that it might do better to hold onto the county land surrounding the airport until such time as the value of the land increased. Rather than sell off the entire asset, the County decided to sell a parcel of land to a private developer to build and operate a parking concession.

Through the drawn-out legal and policy discussions, Albany County found a solution that would lead to airport improvements and some relief from its fiscal difficulties. In the end, the experiment with privatization was scaled back but the planning and negotiation around the idea of privatization had brought in new ideas on how to improve Albany's airport.

Cochin (Kochi) Airport in Kerala, India—private financing from its start

In 1999, Cochin International Airport Limited (CIAL) opened its doors for operations. The construction of this airport, in the Southern Indian state of Kerala, had been financed by private funding schemes and some government support and the facility was being operated as a private entity. Although the airport generated enough revenue to cover its operating costs by 2001, it was struggling to service its debt and could not pay dividends to its shareholders, who were mostly Keralites who were working abroad and had been convinced to invest in building an airport that would make their travel back home easier. Part of the problem came from regional competition. There were three large airports in Kerala within a 400 km stretch along the coast and each one was vying for domestic and international business.

Kerala was India's second smallest state. Its citizens were supported by an agrarian economy. Its most lucrative export was human capital and its most lucrative import was remittances from these ex-patriot workers. With a historically strong support for education, the literacy rate in Kerala was high and workers from Kerala were sought after. These workers were the primary investors in Cochin's airport but they were not yet seeing the fruits of their investments. Issues regarding regional competition as well

as national regulations about international and domestic landing rights would need to be resolved before the experiment of the private funding scheme could be deemed a success or failure.

Privatization in Hong Kong: A Parallel Example

Although the idea of privatization of HKIA had been officially introduced only very recently in 2004, privatization was not a new idea in Hong Kong. The government and the public were familiar with the idea and the process of selling off government-owned and –operated assets through the partial and successful privatization of Hong Kong's mass transit system, the Mass Transit Railway (MTR). Moreover, the pervasive *laissez faire* attitude in Hong Kong went hand-in-hand with general trend for the government to hand over business activities to the business community.

The Mass Transit Railway Corporation (MTRC) was established in 1975 as a government-owned statutory corporation. It was formed to oversee the construction and operation a new underground railway system that would link Hong Kong Island to the Kowloon peninsula through railway tunnels under Victoria Harbor and also modernize mass transportation in the territory.

Train service commenced on 1 October 1979 when 285,000 people used the new underground service. By 1999, after twenty years of service and expansion across Kowloon and out to the airport (see appendix 1), MTR had carried over 11.8 billion passengers and was operating in the red, a rare accomplishment for a mass transit system any where in the world. By the end of 1999, MTRC recorded HK$2.1 billion in profits, but the path to this success had not been easy and had not actually been the result of transit activities. MTRC had made its money in its lucrative development of the properties it owned above its stations. The MTRC had become one of Hong Kong's most expansive land developers.

In 1999, with the effects of Asian Financial Crisis lingering, Hong Kong's Financial Secretary announced plans in his budget speech to partially privatize MTRC through the sale and listing of a minority interest in the corporation's shares. In a paper introduced into discussion at the Legislative Council later in 1999, the government suggested that the scheme to privatize the MTR would lead to the following benefits:

- Provide a useful boost to Government finance in the medium term
- Reinforce the MTRC's commitment to competitiveness and efficiency
- Strengthen the market discipline in the running of the railway
- Broaden the MTRC's access to sources of capital and reduce its reliance on Government equity injection or loans for new railway extensions
- Offer a prime opportunity for the people of Hong Kong to invest in a successful business with strong growth potentials
- Add stability and diversity to the Hong Kong stock market through the flotation of this high-quality, heavily capitalized stock
- Buttress Hong Kong's status as an international financial center through a high-profile and successful public offering

On 5 October 2000, MTRC was listed on the Hong Kong Stock Exchange in a privatization share offer as a new company called the Mass Transit Railway Corporation Limited (MTRCL, later shortened to MTR). The government retained a majority of the shares to maintain control over service and fare levels. In all, 1 billion shares or 20% of the issued share capital of the company was sold in a Hong Kong public offering and an international offering.

In 2004, MTR's shareholders earned HK$.84 per share and had received dividends of HK$.42 per share. The share price was HK$12.45, up from the initial price in 2000 of about HK$8.88 (see appendix 2).

HKIA Privatization: Now or Later?

In 2004, when the new Financial Secretary announced plans for the privatization of the airport, the Government faced a dire economic outlook and had been dealing with budgetary constraints and cutbacks (see appendix 3). Hong Kong's civil servants had, for example, taken a pay cut and all government departments and services had seen budget rollbacks. The deficit was increasing and projections for growth across Hong Kong were grim. Hong Kong had weathered the SARS crisis but the spillover effects were still being felt.

The privatization of additional assets might allow for greater financial flexibility for the government. It seemed to be a good time to suggest that the airport would be the next major privatization project.

By 2005, the economic picture had brightened a bit. The mood around Hong Kong was brighter and the economy looked like it would pick up. Should the government sell its very lucrative asset just at a time when it could use its profits? Should it wait for a bit before selling any property.

The larger question was about privatization of such an important facet of Hong Kong's economy. Privatization of the MTR had been successful but only because the MTR's property developments had been very profitable. Was it a good idea to lose total control of the airport and could HKIA succeed in the way MTR had succeeded? Would privatizing HKIA translate into a more efficient operation or would it lead to strained relations with the airlines and, ultimately, to higher ticket prices and higher transportation costs for cargo? Would it be better to put off plans to privatize the airport until later?