

# The Connectivity Story

The centre of gravity has changed



## The Connectivity Story

### Connectivity

1. New Zealand is an island nation distant from many of its key visitor markets. This means air connectivity is a crucial pipeline for New Zealand's visitor economy. The country is almost entirely dependent on air links to grow visitation with about 95% of all international visitors coming by air. Other jurisdictions, notably those in Europe, have a 50/50 split between air and surface visitors.
2. A recent paper titled *The Principles of Market Access: The Aeropolitics of Capacity Provision* by David Duval states "the vast majority of tourism arrivals to New Zealand are by air. It is thus in New Zealand's best interest to ensure that accessibility is maintained by forming Agreements (Air Services Agreements or ASAs) with States whose airlines are involved in global airlift and who can measurably contribute to visitor arrivals".
3. As well as facilitating tourism, air connectivity supports the government's overall economic agenda and while the focus of the National Tourism Plan (NTP) is on growing inbound visitation, commercial airline services into this country are not sustainable without the more than two million outbound trips made by New Zealand residents each year.
4. For the most part, non-stop and direct air services grow demand more quickly than indirect services meaning the focus of current and future air services agreements (ASAs) should be with countries in the Asia and Pacific Rim, many of which can be reached by non-stop air services from New Zealand.
5. The cruise industry, meanwhile, has experienced rapid growth over the past five years to the point where more than 200,000 passengers visited New Zealand in the 2012/13 cruise season, compared to 118,000 in the 2008/09 season, an increase of 70%.
6. In the past two decades, the centre of global economic activity has shifted radically from one that was focused on Europe to one that is now centred on Asia. New Zealand's geographical location means that it is well placed to capitalise on this global shift.
7. In short, the key principles relating to New Zealand's connectivity are:
  - New Zealand's geography and distance from key visitor markets means international connectivity is a crucial pipeline that will directly influence tourism growth.
  - Future growth for inbound visitors is expected to come from Asia and the Pacific Rim meaning the focus on future connectivity should be with this region.
  - Development of international air services should be consistent with tourism and trade priorities and New Zealand's wider economic interests as well as lining up with government to government Free Trade Agreements (FTAs).
  - There should be a focus on ASAs that offer the best prospect of non-stop air services as these are more likely to grow markets more quickly.
  - Cruise is a fast growing sector of the tourism industry that represents huge growth opportunities for the New Zealand tourism industry.

## **Air Connectivity**

### **What do we know about the link between air connectivity and economic growth?**

8. A paper published by the International Air Transport Association (IATA), titled *Aviation Economic Benefits* describes the role of air transport by saying that it plays a key role in economic development and supports long-term economic growth. It also facilitates a country's integration into the global economy and provides direct benefits through "its positive impact on productivity and growth".
9. The same paper has developed a number of measures that determine the level of connectivity available from a country's major or major airports to the global air transport network. It states "the higher the level of connectivity, the greater the level of access to the global economy".
10. The IATA measure of connectivity considers the number and economic importance of destinations served from a country's major airport/s, the frequency of service to each destination served from a country's major airport/s and the number of onward connections available from each destination. The paper states that "connectivity increases as the range of destinations increases, the frequency of service increases and/or larger 'hub' destinations are served".
11. Connectivity by location depends largely on the size of a country's economy and the number and size of businesses. By nature, the larger economies will have more destinations and seats, but the addition of new services will be more economically significant to mostly smaller countries compared to those countries that are already well connected. For example, an extra ten destinations into the world's busiest airport, Atlanta, will clearly not have the same impact compared to an extra ten destinations into Auckland.

### **Some say New Zealand is already well served by air connectivity**

12. The World Bank *Air Connectivity Index* ranks New Zealand at 142<sup>nd</sup> out of more than 200 countries. Burkina Faso and Kenya take the places above and below New Zealand. Compared to other island nations and countries of a similar size, New Zealand ranks poorly. For example, Ireland is ranked 19<sup>th</sup>, Norway is ranked 24<sup>th</sup>, Cyprus is ranked 54<sup>th</sup>, Jamaica is ranked 67<sup>th</sup> and Iceland is ranked 86<sup>th</sup>.
13. But while New Zealand has a relatively low ranking on connectivity per location, when connectivity per billion of GDP is measured, New Zealand ranks highly at 6<sup>th</sup> in the world behind Singapore, Cyprus, Hong Kong and Switzerland, an arguably more important measure than connectivity by location.

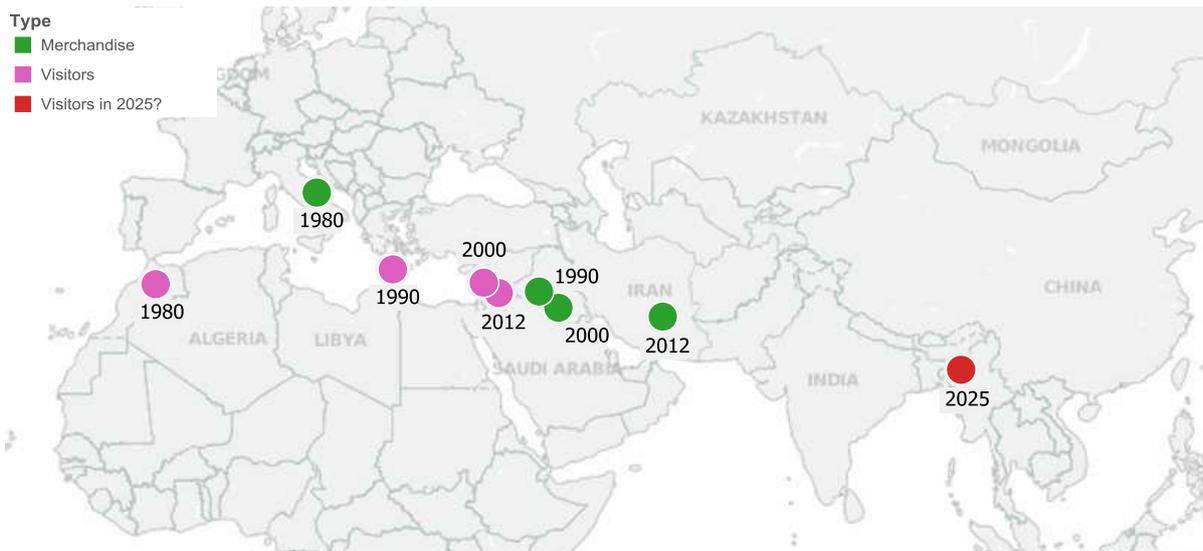
### **So what are the opportunities for New Zealand?**

There are five things in our favour:

a. *A liberal air services policy helps*

14. New Zealand is "open for business" with one of the most liberal air services policies in the world. It has over 50 air services agreements (ASAs) in place, a comparatively large number of agreements given the country's size. Although only about one third of these ASAs have actually been taken up by foreign carriers flying to New Zealand, the liberalisation policy means the regulatory conditions allow for an air route to start up reasonably quickly if the economics of a route can be proven. See Annex 1.





17. To illustrate this point, nine of the ten most populous cities in the world are located in Asia and Latin America with almost all of them within non-stop range of Auckland if the right aircraft are deployed.

City	Rank	Country	Population
Tokyo	1	Japan	35,000,000
Jakarta	2	Indonesia	28,000,000
Seoul	3	South Korea	25,000,000
Shanghai	4	China	25,000,000
Mexico City	6	Mexico	23,000,000
Delhi	7	India	23,000,000
Sao Paulo	8	Brazil	21,000,000
Mumbai	9	India	20,000,000
Manila	10	Philippines	20,000,000

Note: New Zealand currently has non-stop or direct services with Tokyo, Seoul and Shanghai. A new service is set to commence from Jakarta in 2014. New Zealand has ASAs with all the countries listed in the table above.

*c. A strong brand attraction helps even more*

18. New Zealand has a strong country brand recognition ranking highly across a range of measures, with *Future Brand* ranking the country fifth overall in 2012/2013. *Future Brand's* philosophy is based on the notion that countries themselves 'have the potential to become some of the world's strongest brands, rivalling big corporate organisations like Nike, Sony and IBM. *Future Brand* says countries that are well branded use amongst other things, global sports events (e.g. Rugby World Cup), environmental reputation and occasionally charismatic political leaders to grow their economy, investment and exports. Until now, New Zealand has largely used its environmental reputation to build its brand.

19. As *Future Brand* points out, 'building a country brand requires more than a focus on tourism'. There are many other factors that come in to the mix. New Zealand's independent foreign policy and indigenous culture are important, but so too is stable government, security, free trade, a supported health and welfare system, acceptable labour standards, protecting intellectual property and friendly people. New Zealand excels in most of these factors.

d. A hub between Asia and South America - fantasy or reality?

20. New Zealand's liberal air policies support the concept of Auckland as a hub between Asia and South America. The large cities of South America, Buenos Aires, Santiago and Sao Paulo are within the right deployment of aircraft, all within non-stop range of New Zealand. In fact, Santiago is already served from Auckland with Lan Chile.
21. The July 2012 edition of *Airline Weekly* in an article titled "The Lure of Latasia" discusses the Asia-South America aviation market. Apart from the Australia-Europe route, it is the only other sector not able to be served by non-stop services. The UK (with a population of 60 million) and Australia (with a population of 24 million) still have more passengers than Latasia, but the potential from the region is staggering. East Asia's population is 1.5 billion and Latin America is 600 million. The Latasia route also offers more lucrative yields than the low fares that characterise the so-called "Kangaroo" route.
22. But there is one major challenge for New Zealand and that is distance. Currently, most Asia to South America traffic is routed through Europe, North America or the Middle East and for two reasons. First, the distance is shorter and second, there is a larger pool of customers, especially in the heavily populated European and North American hubs. *Airline Weekly* lists 14 market-leading city pairs and the top five airlines and hubs for each of those pairs e.g. Sao Paulo-Shanghai with Emirates and Buenos Aires-Beijing with Air France. Of the 70 combinations, just one, Buenos Aires to Tokyo is via Australasia and that's Qantas via Sydney.
23. So what would need to change for the "Latasia" concept to be more than just fantasy? Lots. The experience in Auckland would need to be seamless in every respect as well as being far better than what's on offer anywhere else. For example, Chinese travellers can transit visa free on route to Sao Paulo from Beijing and so too can travellers from Singapore to Sao Paulo via Barcelona. So to be serious about a "Latasia" hub concept, New Zealand would need to complement first class facilitation by relentlessly promoting its brand recognition as a point of difference against European, North American and Middle Eastern hubs.

Asia	Primary connection point	South America
	% of traffic (pax)	
	<u>North America</u>	
	2008: 39%	
	2012: 21%	
	<u>Europe</u>	
	2008: 37%	
	2012: 42%	
	<u>Middle East</u>	
	2008: 10%	
	2012: 32%	
	<u>Africa</u>	
	2008: 8%	
	2012: 4%	
	<u>Oceania</u>	
	2008: 1.5%	
	2012: 0.8%	
	<u>Other (complex multi-stops)</u>	
	2008: 4%	
	2012: 1%	

e. We have the capacity

24. New Zealand is in a position to grow efficiency and scale without compromising existing services or facilities. Investment in broader infrastructure needs are now starting to be met with commitments confirmed for a national convention centre in Auckland and regional convention centres in Christchurch and Queenstown. Port facilities are now starting to be upgraded in Auckland and in other centres around New Zealand to meet the growing demand from the cruise industry.
25. To reach a significant growth aspiration by 2025 as set out in the NTP vision statement, New Zealand would need the following additional air capacity....

Projected extra daily services required by 2025 - based on arrivals forecasts/aspirations		
Source	Scenarios (visitor #s)	No. of extra daily services*
Baseline - 2013	2,616,000	
UNWTO/Boeing (Bottom of range)	3,500,000	22
UNWTO/Boeing (Top of Range)	4,200,000	39
COVEC	3,600,000	25
NZIER	4,400,000	44
Auckland Airport - Ambition 2020	5,300,000	67

\*1 extra daily service = 365 days per year.

### Different carriers bring different advantages

26. The national carrier brings approximately 40% of inbound visitors to New Zealand with foreign based carriers bringing the remainder. As a Star Alliance carrier, Air New Zealand provides domestic/regional connectivity for international passengers from its Star Alliance network while foreign carriers open up new markets served by other airline groupings.

### Role of Air New Zealand

27. A successful and profitable national carrier is an important contributor to the economy, not just because it supports the tourism industry, but because of the more than 10,000 jobs it provides across a range of occupations, including engineering and catering. The airline also invests significantly in marketing New Zealand offshore.
28. In recent times, the economics of the national carrier has been observable as it scales back inefficient routes and focuses on those that deliver it the best returns. In past years, this has seen it withdraw from places like Singapore (to leave the route to its Star Alliance partner Singapore Airlines), Beijing and Frankfurt.
29. Apart from its services to London, Air New Zealand is essentially a regional Asia/Pacific Rim carrier that relies on its Star Alliance partners to feed passengers to its long haul Asian and North American services and domestic New Zealand networks.

## Role of foreign carriers

30. Arguably, foreign carriers get more from ASAs than the national carrier. For example, the larger carriers from relatively small economies, like Singapore and even Dubai, funnel visitors in and out, with only minimal investment in promoting New Zealand Inc.
31. A question for future consideration is whether future rights with foreign based carriers should be predicated on the basis of non-stop services as these grow inbound markets more rapidly. At the same time, it is worth considering the impact that new services have on existing services. To achieve visitor growth is it really worth risking the sustainability of existing airlines, some with long held commitments to New Zealand, for the sake of a new service or would we better to get that growth by increasing the commitment from existing airlines serving New Zealand?
32. Future ASAs might also want to give a nudge to airlines with a regional New Zealand strategy. If the NTP is going to deliver benefits to more than just Auckland and its surrounds, then other airports, possibly Christchurch and Queenstown should have a part to play as well.

## What makes a route profitable?

33. Clearly the right way to invest in air connectivity is to develop sustainable markets by passenger volume and yield, cargo, and domestic linkages. But looking at the composition of an airfare and the various regulatory charges that are contained within that fare is another way of understanding profitability. An analysis provided by Air New Zealand shows what % of selected airfares comprises government and airport taxes.

### % of average fare that is Government & Airport taxes

#### Inbound to NZ

	C	U	Y
LAXAKL	1.18%	2.27%	4.90%
NRTAKL	1.87%	2.99%	4.64%
PVGAKL	1.23%	2.18%	3.93%
LHRAKL	8.71%	13.71%	15.91%

#### Outbound from NZ

	C	U	Y
AKLLAX	1.82%	3.49%	7.43%
AKLNRT	1.85%	2.98%	4.61%
AKLPVG	1.09%	1.92%	3.47%
AKLLHR	1.13%	1.87%	3.50%

Note; these figures are a guide only and not 100% accurate for the following reasons;

- This is based on non-directional average fare data by route in NZD (non-directional)
- I have converted the taxes & airport charges it to NZD and added to average net fare data in order to get total fare.
- The results may differ if you were using average fare data that is directional and adding taxes and fees in local currency.
- C = business class, U = premium economy and Y = economy

### *Case study - Air Asia X*

34. Air Asia X commenced services into Christchurch in April 2011. There were a number of factors that attracted the Malaysian airline to New Zealand, including:

- South Island tourism products
- little long-haul competition
- latent demand with not much capacity

35. From the outset, Air Asia X proved the point with massive stimulation to the market for New Zealand from Malaysia visitors. The numbers increased from 22,000 per annum in 2010 to 38,000 per annum in 2011, but as soon as Air Asia X pulled out of Christchurch in May 2012, these numbers quickly returned to their original level, at around 24,000 per annum.

36. So why did it fail? Clearly, Air Asia X's entry couldn't have been a case of worse timing only two months after the February 2011 Christchurch earthquake. But there were other factors at play as well, including:

- A review of all long-haul Air Asia X long-haul services that saw the airline also withdrawing flights between Malaysia and India and Europe.
- An impending Initial Public Offering (IPO) of the airline and ructions around a common share ownership of Malaysian Airlines (the government owned Malaysian Airlines was seeing reduced loads on its Kuala Lumpur service because of Air Asia X's introduction)
- Poor yield management – it simply came into the market with fare levels (\$99 for a CHC-KUL leg) that were not sustainable.
- Poorly organised industry engagement and product packaging in the lead up to the route commencing which only became organised by the time Air Asia X was about to withdraw.

37. One of the main features about the Air Asia X service was the impact it made on international visitor spend in the South Island as most of those in flying in were Malaysian free independent travellers (FITs) with an average spend of nearly \$3,000 per head. Air Asia X, although an LCC, was bringing a significant number of higher value spending holiday visitors.

38. Who lost the most? Christchurch Airport lost hundreds of thousands of dollars from the withdrawal of Air Asia X, but the biggest loser was the collective tourism industry that lost more than \$50 million.

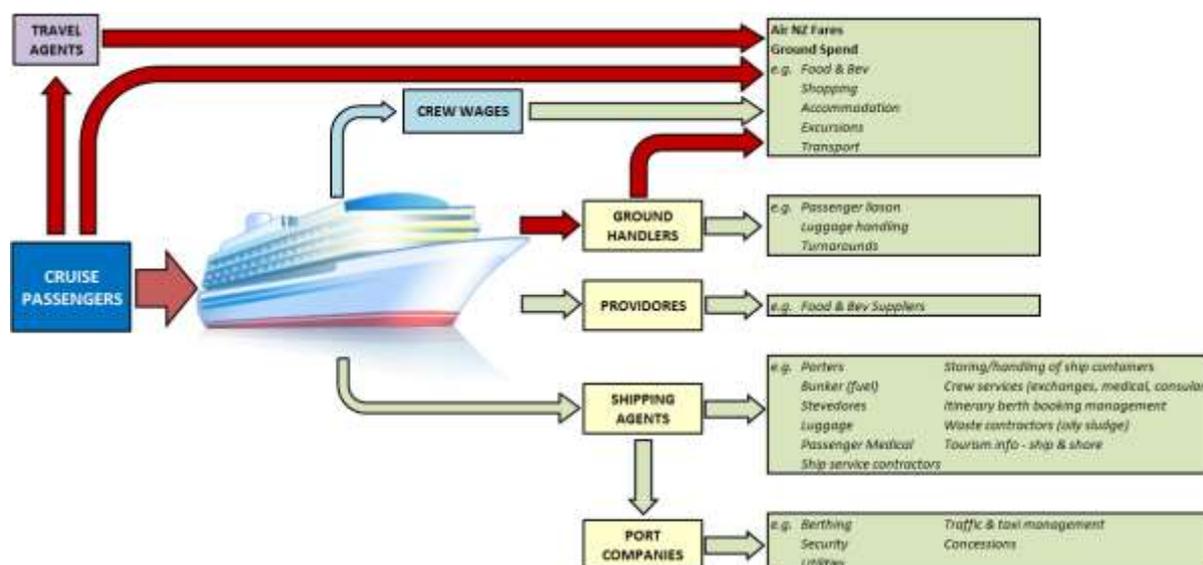
### **The industry has the potential to support airline profitability and sustainability with demand and supply side initiatives**

39. Although there were other mitigating circumstances, the example of Air Asia X demonstrates that without coordinated industry support including the right product, packaging and channelling, new air services are less likely to be sustainable. Airlines and airports may shoulder some of the risk (and cost) associated with bringing in new services, but ultimately the failure of the industry to be organised and coordinated means they stand to lose the most. Measures the industry could take to assist include partnering with airlines and tourism bodies in both demand and supply side initiatives.

## Cruise

40. Cruise is growing at a much faster rate than any other sectors of the visitor economy. In terms of raw numbers, 208,000 visitors travelled to and/or from New Zealand on a cruise ship in the 2012/13 cruising season. This is a 70% increase since 2008 when 120,000 visitors came to New Zealand on a cruise vessel. After China, cruise passengers are effectively New Zealand's third largest source of visitors and if they were to be included in official International Visitor Arrival (IVA) data, then we would have had 2.8 million visitors year to date.
41. So we need to understand this market better and adapt to it in order to extract more value from cruise passengers? While it leaves relatively less money in the pockets of New Zealand's tourism operators it does have a low infrastructure footprint and industries beyond tourism do benefit as the diagram from a Covec study completed in September 2012 illustrates. These industries include providers, shipping agents and port companies.
42. In terms of direct expenditure with New Zealand based businesses, this amounted to \$132 million in the 2011/12 year. Of this, spend on excursion and activities amounted to \$54 million and spend on retail shopping amounted to \$36 million, with the rest spent on areas such as hospitality.

Cruise expenditure channels – how the money enters the New Zealand economy



43. Looking ahead, the future for cruise is positive. Cruise New Zealand is forecasting a slowing down of growth over the next two years, but after that growth is expected to pick up again, especially when the Panama Canal extension is complete in 2015 allowing larger cruise ships to come down to the South Pacific in the northern hemisphere winter.

End