



“Aviation’s center of gravity continued to shift eastward”
-IATA, 2016-



Positive Sign of Aviation’s Industry

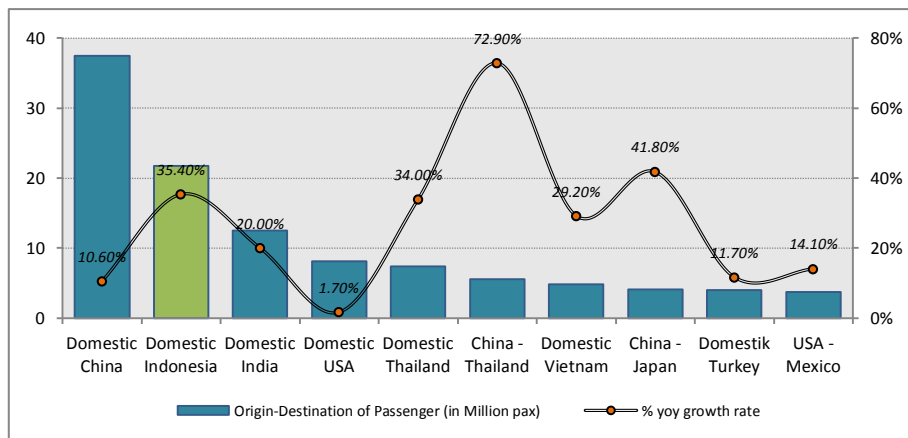
It has been a long time for the airport to become a crucial element for the transportation infrastructure in a country. Not only limited to infrastructure alone, the airport has grown into a mature business that provides a variety of services to its customers (Bilotkach *et al.*, 2012). The efficiency factor of time, scope of areas, and cost for the several years experienced a major revolution with the appearance of Low Cost Carrier (LCC) that increase the airport business and occupancy.



Source: Photo by José Martin (www.unsplash.com)

In the airport scheme, the airline companies are an important aspect and factor. In year 2016, International Air Transport Association (IATA), as one of the association's largest airline company in the world with a membership of more than 250 airlines from 117 countries, issued an interesting report to observe with the theme "Continuing recovery", which implicitly shows that the airline companies had experienced struggles in the aviation business.

Overall, during 2015 the main achievement of the aviation industry has been achieved; Airline companies have successfully generate returns higher than the cost of capital. Generally, It is the first time in history that an airline company posted a profit (IATA, 2016). Reflecting on the domestic level, Garuda Indonesia as a red plate flight carrier, in 2015 recorded a positive net profit, whereas in the previous year loss nearly US\$ 340 million



It is also interesting to see the origin-destination (OD) of passengers who turned out to be coming from the east as a positive sign in the aviation industry. In 2015, 7 out of 10 OD with the highest passenger came from Asia, and Indonesia was in the second place.

Source: IATA, 2016 (Redrawn)

However, the increase in such needs can be like a double-edged knife, which is not only a positive news for businesses especially operators, but it can cause problems such as flight delays, and the need to expand capacity and control (Chen *et al.*, 2015). Airport operators should be more prepared to provide modern facilities and services for flight passengers that continue to grow over time (Manzoor, 2010). From the airport operator side, Airports Council International (ACI) as an association of airports in the world that handle 592 members and 1,853 airports in more than 170 countries continues to prioritize safety and security aspects. ACI aware that the present and the future, airport is not only just an infrastructure entity, but can be business-minded entity, so the focus should be prioritized is to serve passengers with the best. In 2014 and 2015, the health level of the overall airport operator is strong enough showed by the growth in revenue in line with the growing demand for air transportation (ACI, 2016).



Airport Business Overview



Source: Photo by Erez Attias (www.unsplash.com)

After the deregulation of the airline industry has been executed during the year 1999-2000, the aviation industry in Indonesia is growing rapidly. One of the benefit of the deregulation is it provides easier authorization to stimulate investment in this business (AP I, 2016). Since then, many new airlines arise such as Lion Air, Sriwijaya and Batavia Air (which later declared bankrupt in 2013). It also directly affects the quantity of the airport and the business that grow to support the activities of airport.

From the side of the airport management, the application of Act No. 1 of 2009 is also a challenge for the airport operator. Act No. 1 open opportunities to anyone as long qualified as an Airport Business Entity to manage the airport. The implementation of Act No. 1 also directly impacting the revenues of the service operator, because as of January 2013 occurred a separation of Air Traffic Service (ATS) which is estimated to reduce revenues nearly 600 Billion per year (AP I, 2015)

The existence of airport runway, control tower, and other facilities has become several causes for the airport businesses to be classified as an imperfect competition (Domney *et al.*, 2005). Not to mention the high operational costs such as land acquisition for the expansion, the high negative externalities factors, and the high opportunity cost when the airline moved their operations hub. These are the factors that create the entry barriers in this business (Domney *et al.*, 2005). Therefore, despite the deregulation of legislation, private sector investment is not easily and immediately realized

The existence of strong regulation and support is an important factor in leading private investment. If the regulation is weak, then the business airports will be an imperfect competition by itself and even tend to monopoly, following the market power (O'Donnell *et al.*, 2011). Domney *et al.* (2005) said to increase more private involvement in the process of the airport business must be guided by a clear regulation and intervention from the Government.

Generally, airport's business and its sources of revenue can be divided into two parts; Aeronautics and non-aeronautics. However, along with the development of the cargo business, several operators and associations have already started to divide their source of revenue into three parts: Aeronautics, Non-Aeronautics, and Warehousing



Source: Photo by Illia Cherednychenko (www.unsplash.com)



AERONAUTICS



NON-AERONAUTICS

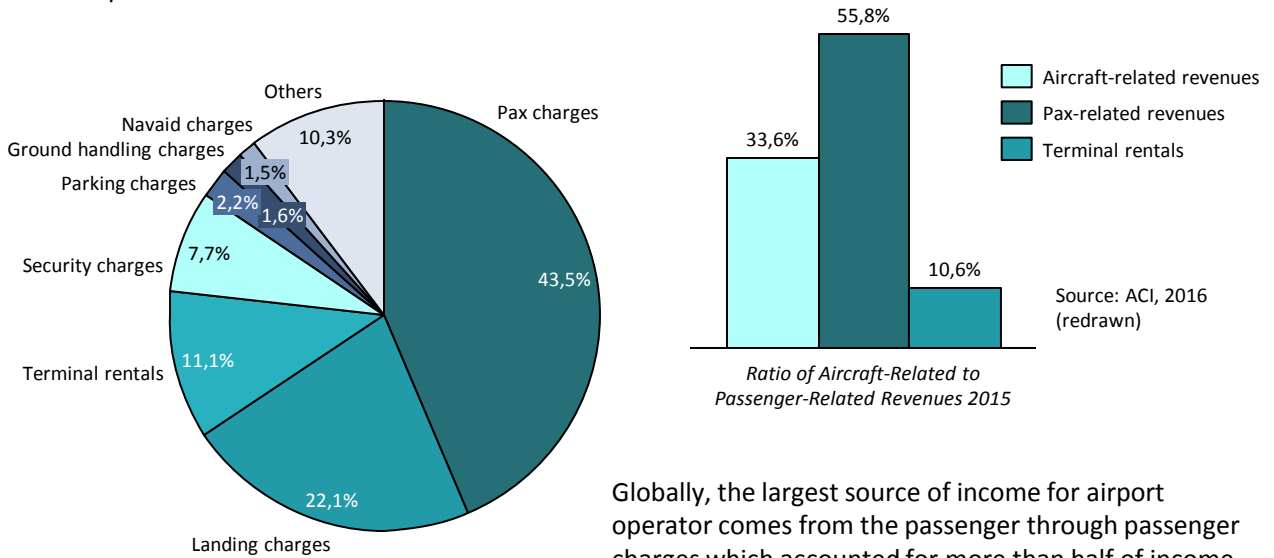


WAREHOUSING

Aeronautics

Simply put, aeronautics is a 'traditional' airport business which are directly related to aviation activities such as runway, aircraft parking, and terminal (Bilotkach *et al.*, 2012). Aeronautics is intimately associated with the airlines and passengers. Globally, these businesses have contributed the largest revenue percentage for the airport operator, even though in some countries that have implemented privatization, aeronautical charges are generally lower (Bilotkach *et al.*, 2012).

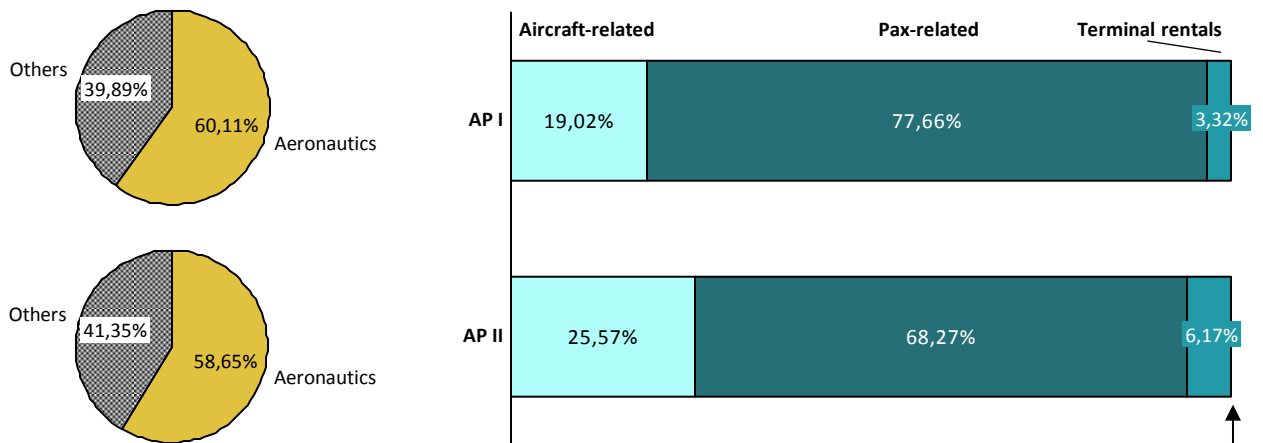
ACI (2016) convey aeronautical Operating Income Distribution Of global operator service Operator Worldwide WITH description as follow



Source: ACI, 2016 (redrawn)

Globally, the largest source of income for airport operator comes from the passenger through passenger charges which accounted for more than half of income portion of the overall aeronautics.

The condition is not really different in the domestic level. Airport Operator in Indonesia, which by market size is dominated by Angkasa Pura I and Angkasa Pura II with a total of 89.7% (AP I, 2016), has a bigger share portion in aeronautics business than the other revenue sources, with also the largest passenger-related portion



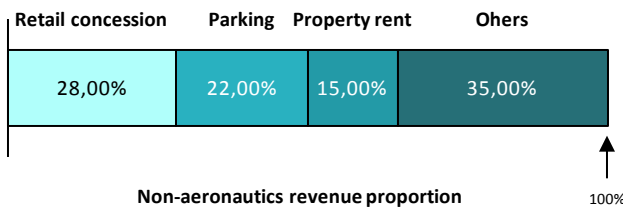
Source of Airport Operator's Income in Indonesia (AP I and AP II)

Source: AP I & AP II, 2016 (processed)

Non-Aeronautics

In the airports business, the non-aeronautics side has a quite promising contribution. Especially because of the development and modernization of airport, the non-aeronautics aspect can not be underestimated. In the last 25 years, the commercial revenue from the non-aeronautics side has been growing very fast compared to the aeronautical revenues. In fact there are some airports that have main revenue sources from non-aeronautical side (Bilotkach *et al.*, 2012). Van Dender (2007) said that during 1998-2002, 55 major airports in the United States has a concession income (a non-aeronautical revenues), which represents more than half of total revenue of airports.

Non-aeronautics business is a source of commercial revenue derived from the operations inside of terminal and airport area including concessions such as shops, restaurants, rental, parking, and others (Bilotkach *et al.*, 2012).



Globally, from year to year, revenue from retail concessions still the main source of income in the non-aeronautics side. Even at the airport in the Middle East region, the concession of retail contributes for almost 55% of total non-aeronautics revenues (ACI, 2016).

Source : ACI, 2016 (processed)

In Indonesia, because of the ATS business delegation to Lembaga Penyelenggara Pelayanan Navigasi Penerbangan Indonesia (LPPNPI), the airport operator is very committed to develop the business of non-aeronautics with Airport City concept, which changes the orientation and the business process to prioritizes the non-aeronautics and customer satisfaction (AP I, 2016). Generally, non-aeronautics business in Indonesia consists of several segments:

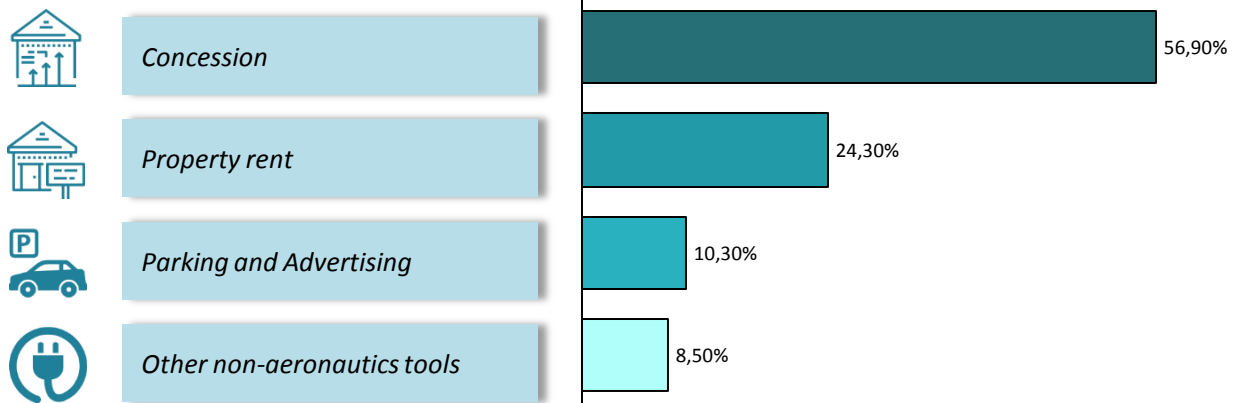


Illustration of non-aeronautics business and & revenue proportion

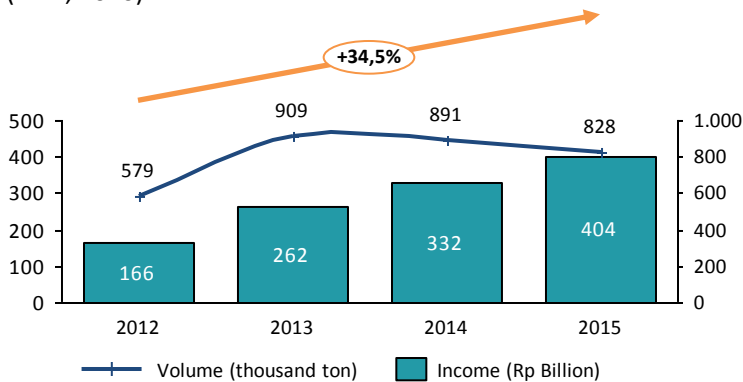
Source: AP I & AP II, 2016 (processed)

Concession segment is the largest source of income for the non-aeronautics. In a general context, the concession can be interpreted as the right for a private company to operate the infrastructure service and receive income from the operation. Concessions is very variative depend on the allocation of risk, incentive, investment, responsibility, and how rates are determined. Usually concessionaires pay a fee to the concession grantor, responsible for the cost of investment, and collect payment directly from customers (OECD, 2010).

There are three main aspects that differ concession with privatization. The first is the physical assets are owned by the government, although the utilization of the assets depend on the concessionaires. Second, there are limitations to the contract (usually 10-30 years), and the last is the government still supervise the asset management (OECD, 2010).

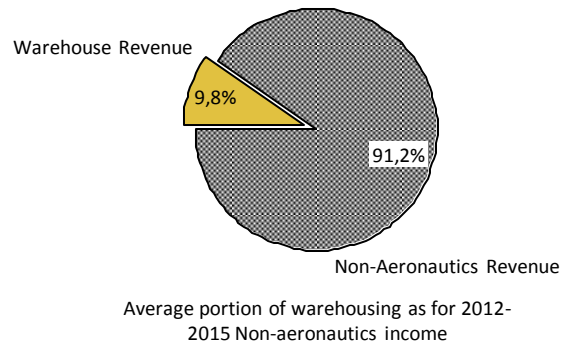
Warehousing

Warehousing is a business outside of aeronautics. In some references, this business are still categorized as a non-aeronautics segment. Definition of warehousing business is an airport business that provide delivery services (AP II, 2016).



Source: AP I dan II, 2016 (processed)

During the period 2012-2015, there was an interesting phenomenon related to growth in the cargo business. In terms of volume (tonnage), there is a downward trend since the year 2013 by almost 5%. However, on the contrary, the revenue received by the operator raised quite stable with a CAGR of 34.5% (for the period 2012-2015).



Average portion of warehousing as for 2012-2015 Non-aeronautics income



Source: (www.pixabay.com)



Airport Privatization Issue in The World

There are challenges as well as opportunities for the aviation industry (airlines and operators) in response to the implementation of Act No. 1, which give an opportunities for the private sector to manage the airport as well as the ASEAN Open Sky Policy in order to create ASEAN Economic Community. Both these policies requires the readiness of the airport to constantly improve service, including safety and security standards for flights (AP I, 2016). Another growing issue is privatization. This privatization is a concern to airport operators in Indonesia. In the Annual Report 2015, even Angkasa Pura I prepare the company's resources in order to be ready for privatization in the strategic long-term plan.



Source: Photo by Rob Bye (www.unsplash.com)

Minister of Transportation Indonesia, Budi Karya Sumadi said that until present time the Ministry of Transportation has prepared three airports outside of Java to be privatized by the private sector. All three airports are located in Balikpapan, Makassar, and Kualanam. He explained that the government wants to gather private funds to help the development of Indonesia.¹

In the world, airports generally are owned and managed by the government, one through the enterprise. Nevertheless, the issue of privatization of the airports in the world into an interesting discussion. There are many countries with adherents of modern economics make the privatization policy as an effort to provide services and better facilities (Manzoor, 2010). The reason often raised regarding privatization is to overcome the inefficiency management of the airports by the government (Domney *et al.*, 2005). Privatization of airports was first initiated in the UK around the 80s. Since then, several airports in the world began to privatize, as in Europe, Australia, and New Zealand. Followed by some developing countries in Asia, Latin America, and Africa (Bilotkach *et al.*, 2012).

¹ <http://industri.bisnis.com/read/20161027/98/596355/kemenhub-siap-privatisasi-bandara> [accessed on 10:33 WIB , 27/12/2016]

Case #1: Privatization Issue in India

India is one of the countries with the largest population in the world. With a population of nearly 1.2 billion, one level below China, transportation becomes important, including air transport. The air transport in India is growing very rapidly resulting in high demand for airport infrastructure. But unfortunately, many airports in India face serious infrastructure problems related to the lack of modern facilities, the passenger density, and other supporting infrastructure (Manzoor, 2010). There are many of those who support, but not a few who oppose.

In the case of privatization in India, Manzoor (2010) noted at least some support and criticism as follows:



- Privatization is beneficial, can help the government to make the airport more modern technically
- Modern airport can bring forward the economy as well as tourism
- Airport operating costs by the government is very high
- Improved operating efficiency and maximum service level
- Funding needs is not a major problem in the private system



- Privatization is harmful to the growth of the development of the civil aviation industry in India
- Privatization is harmful to national security, because private operators are less able to provide the best security systems at airports
- Operator government entities will lose a large role in the aviation sector
- 40% loss of jobs and increase unemployment

Case #2: Airport Privatization in Australia – Sydney, Melbourne, and Brisbane Airports

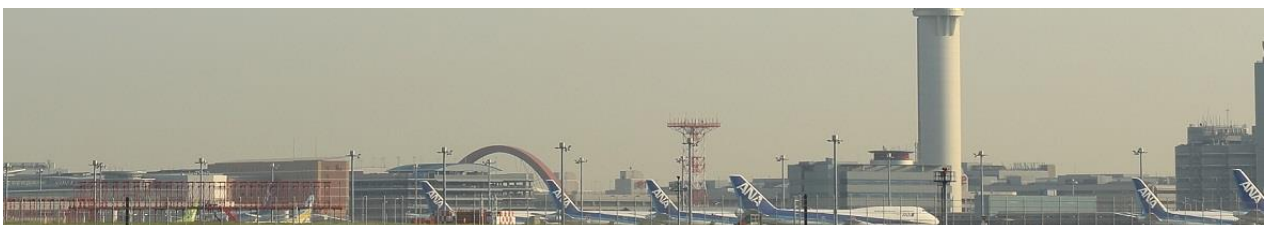
Generally, the management of Australian airports owned and operated by the Federal Government through the Federal Airport Commission (FAC). However, since 1996, FAC announced that some airports will be privatized by way of divestment (Aulich and Hughes, 2013). Since then, three major airports in Australia privatized are Sydney, Melbourne, and Brisbane.



Sydney Airport (SYD) has been officially privatized since June 2002 with a cost to be paid by the private sector amounted to \$ 5.6 billion. Private acquire full rights with the lease scheme for 50 years and the option of renewal for 49 years to operate the airport.

Since privatized, in addition to the year 2007, SYD has always suffered operating losses each year. One of them is because a significant enhancement of liabilities portion for almost 7 times higher than before privatization (Aulich and Hughes, 2013).

The business performance shows that the privatization of the business monopoly would not have led to improved financial performance. Although SYD is able to produce doubled amount of money circulation from customers, significant advantages is still unattainable (Aulich and Hughes, 2013)



Sumber: Photo by Kazuend (www.unsplash.com)



Just like SYD, Melbourne Airport (MEL) has been privatized since 1997 with a value that must be paid for 1.3 billion with a 50-year lease scheme with 49-year renewal option

Since privatized, MEL losses annually. But since 2007, for the first time since privatization, MEL posted positive gains. MEL liability level is much lower when compared to SYD which resulted in low borrowing costs. The amount of assets is always beyond the liabilities level is suppose to be the cause. MEL policy to control over the liabilities and borrowing costs, resulted in better performance compared to Dubai (Aulich and Hughes, 2013).

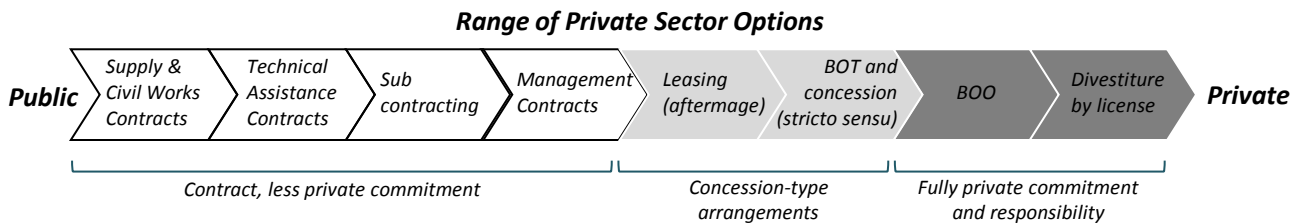


Brisbane Airport (BNE) was privatized in 1997 with a value of \$ 1.4 billion and with the same scheme as SYD and MEL. In the first year after privatization, BNE experiencing Break Even Point with a record profit of \$0. Since then, BNE financial performance varied.

Unlike SYD, BNE is able to generate positive operating cash flow and able to maintain positive net assets. However, financial data show that privatization does not always result in better financial performance compared with FAC (Aulich and Hughes, 2013).

Some examples of privatization cases shows that the idea as rumored in India that privatization would push to increase the operating efficiency and financial performance is not necessarily so. The model of privatization selection should be considered with caution, especially if related to big transportation facilities (Aulich and Hughes, 2013).

In the context of the airport, privatization is not always defined as the overall sales of assets, but may vary from supply contracts and civil works up to divestment (Ohri, 2009).



The World Bank in Ohri (2009), summarizes the general options in the privatization as outlined in the following table :

| Responsibilities Allocation | Opsi 1 | Opsi 2 | Opsi 3 |
|---|---------------------|----------------------------------|------------------------------|
| Ownership | Public | Public | Private/Mixed |
| Investment | Public | Private/Mixed | Private |
| Management and Operation | Private | Private | Private |
| Common strategy in the private sector participation | Management Contract | BOT, Long-term lease, concession | BOT, buyout, capital markets |



Airports are increasingly being viewed as a business, not limited to infrastructure which is the responsibility of government (Ohri, 2009). Therefore, business development at the airport (outside the aeronautics business) into something important done. Airport operator in Indonesia, has done a lot of diversification to the business through intensification or through subsidiaries, mainly post-deregulation, acquisition ATS, and the Open Sky Policy. The business sectors of logistics, properties, hotels, transportation, and retail are the new lines of business in recent years that developed to maximize the revenue of non-aeronautical side.

Environmental and sustainability issues is also an important factor to consider in the airport concession, especially related to the development and expansion. Airport development has always caused controversy because it has a direct impact on the local community / roughly like land acquisition, noise, pollution and congestion (Kaszewski and Sheate, 2004).

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