INTERNATIONAL FINANCE – COVER STORY

Who will bring the world to Africa?

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After the collapse of South African Airways, a clear winner has emerged among continental airlines in the fight for dominance of the African skies – Ethiopian Airlines. The key factor behind the success of Ethiopian Airlines and the failure of South African Airways is the same – the government. What did they do so differently?

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Business failure, grounding, or persistent deep losses are the norms for national airlines worldwide and state airline failure is virtually universal in Africa. Then, how likely are the chances that one of the world's best managed and continuously profitable national airlines is an African airline? The fact is, Ethiopian Airlines is Africa's most profitable continental airline and one of the most successful state-owned airlines in the world. Established by a royal decree from Emperor Haile Selassie in the 1940s, Ethiopian Airlines is today the market leader in seat capacity among local airlines in Africa with a 9 percent share. In terms of seat capacity, the airline is twice larger than its next two African competitors Morocco's Royal Air Maroc and South African Airways. In 2010, Ethiopian was smaller than the two airlines and even smaller than EgyptAir.

Bringing the world to Africa and taking Africa to the world was once the proud motto and catchline of Africa's once biggest airline: South African Airways. Today, South African Airways is a pale shadow of its former self and the carrier is literally fighting for survival. How did Ethiopian Airlines succeed while many national airlines have failed? How did government control enable Ethiopian's success while at the same time ensure South African's collapse? Moreover, does Ethiopian Airline's success mean that the hub of African aviation is shifting from the south to the east of Africa?

Why Ethiopian Airlines holds a unique place in aviation lore

According to the latest figures released by the Ethiopian Public Enterprises Assets and Administration Agency to which the Ethiopian Airlines management reports to, Ethiopian Airlines Group generated total revenues of about $4.2 billion in the fiscal year concluded July 7, 2019, with a profit before tax of about $326 million. More than 90 percent of the revenue earned by Ethiopian Airlines Group is in the form of hard cash from customer bookings and services.

Ethiopian Airlines expected to earn a revenue of about $5.7 billion with about $696 million in profit before tax in the fiscal year to July 7, 2020, according to figures released before the Covid-19 pandemic hit. The airline flew 10.6 million passengers in 2017-18. Ethiopian's ambitions are literally sky high today. According to its future strategy outlined in Vision 2035, in addition to enhancing capacity at Addis Ababa's Bole airport, which is its hub, the airline now plans to build Africa's largest airport at a cost of $5 billion 40 miles south of Addis Ababa.

Ethiopian Airlines has also helped revive other African airlines through cross-border joint ventures, thereby positively impacting the growth of the African aviation sector and increasing connectivity across Africa as a whole. The carrier owns 49 percent in Malawi Airlines and 45 percent in Zambia Airways. Following upon its Vision 2025, it spread its wings across Africa and established a subsidiary in Mozambique in 2018, Ethiopian Mozambique Airlines that connects destinations within Mozambique. There are very few profitable airlines among the scores of national carriers worldwide. This makes Ethiopian Airlines not only an African success story, but also a global aviation success story.

Shut down or restructure: South African's dire predicament

South African Airways was supposed to be Ethiopian's top African challenger. South Africa is still the largest aviation market on the continent. It has a large domestic aviation market and is a popular destination for tourism and business travellers. But South African Airways current state is dire and the stark opposite of that of Ethiopian. A team of business rescue practitioners is expected to present a rescue plan for South African Airways on March 31 this year.

The airline last made a profit in 2011. Multiple attempts to revive it have failed. According to an analysis done by Bain Capital in 2018, if the airline was to be liquidated, it would have to cover liabilities of between R35 billion ($2.4 billion) and R48 billion. At the same time, from a fire sale of its assets, the airline would be able to generate only R5 billion to R6 billion. Liquidation would also put the national treasury under pressure, because the treasury would have to settle R15.3 billion in bank debt and creditor guarantees prior to the airline's shutdown.

Although the South African Minister for Public Enterprises Pravin Gordhan was of the opinion that the airline could be restructured and resurrected, the finance minister Tito Mboweni had once advocated grounding the airline entirely. Meanwhile, the team of business rescue practitioners working to salvage the airline have suggested eliminating a number of flights from South African Airways' schedule that can hit African aviation hard, because they include some of the key connections between leading African business destinations.

Liquidation is among the wide range of interventions thought out by the business rescue practitioners Siviwe Dongwana and Les Matuson. Dongwana and Matuson expected around 8,900 job losses and an immediate liability of R6.3 billion to the government from settling South African Airways' short and long term debt. The business rescue plan is not yet final and the idea of liquidation might not even be mentioned when Dongwana and Matuson present their final rescue plan by March 31.

Since 2008, South African Airways has survived on tax-payer funded government bailouts to the tune of R22 billion, due to which the finance minister has a point in saying that the airline must be grounded. But any decision to ground the airline will be influenced by the strong unions in South Africa. To add to that, in his budget speech to Parliament at the end of February 2020, Finance Minister Tito Mboweni revealed that the government would provide South African Airways R16.4-billion in government support across three years to cover debt and interest payments.

How government interference killed South African Airways

As a matter of fact, South African airlines had outlived the utility for which it was established. The isolated Apartheid government started the airline to ensure that the country was connected to the outside world – to survive the isolation imposed by Apartheid sanctions. The airline never had to disclose its financial statements because it performed a strategic role in providing necessary economic connectivity for South Africa to the rest of the world. Even when Africa closed its airspace to South African Airways, it could fly around the coastal route of West Africa.

"The airline could never sustain profitability and didn't indeed know the extent of the subsidy it was getting from the South African government," Guy Leitch, a leading South African aviation analyst and the publisher of Africa's largest aviation publication SA Flyer, told **International Finance**. After Apartheid, the ANC centralised government control over the airline, which was very much in line with the government's or ANC's policy of government control over key national assets.

Although there was a period when the government seriously sought to privatise the airline, the carrier's privatisation has otherwise been mostly off the table, especially, during the Jacob Zuma presidency. For South African Airways a 'manageable' loss of around a billion rand had been the norm since the end of the Apartheid, except for a few years here and there. The taxpayers of South Africa were used to the idea of subsidising the airline for about a billion rand per annum for the sake of its developmental objectives such as the South African Airways pilot cadet scheme that was intended to support the development of pilots from economically disadvantaged groups.

The airline made a number of attempts to break even, with the most notable one in 2008, when it made two attempts with the first one badly failing. The second one was called the Bambanani programme by which the government recruited Khaya Ncqula as CEO to pare down a large part of the organisation that had become deadwood and the airline briefly returned to profitability for two years in 2010 and 2011.

The airline entered a very dysfunctional period when one of Jacob Zuma's acolytes Dudu Myeni was appointed to the board and she then became chairperson. Along with the notorious state capture saga that engulfed the whole Zuma government, South African Airways and the contracts from South African Airways became the focus of loot and corruption under Myeni and the losses of the airline soared from R1 billion to around R6 billion. Myeni is currently under investigation over the issue but has denied personal culpability. "The key difference here is that the R1 billion in losses per annum could have been sustainable, however, R6 billion in losses was never sustainable and yet the government continued to interfere," said Guy Leitch.

Long protected from domestic and international competition by the state, the business can no longer compete on an equal footing with the competition, especially with the Middle Eastern airlines. "The prominence of the Middle Eastern airlines in the last 10 to 15 years together with their business models anchored on hubs have laid an assault on the business models of not only South African Airways, but also many other international airlines," Perry Munzwembiri a Zimbabwean economic and financial analyst focusing on sub-Saharan Africa and also the head of research at advisory and consultancy firm GrowthPoint Capital Zimbabwe, told **International Finance**.

"South African Airways no longer has the economies of scale in terms of route networks, passenger capacity, and cargo freight to compete internationally because of its poor geographic location. Simply put, it is outside the longitude necessary to achieve the efficiencies needed to survive as an airline. Of course, other factors such as mismanagement and corruption cannot be ignored in analysing how the airline is where it is today," he added.

"South African Airways, essentially, no longer has a compelling economic case for survival as a business, and accumulated losses of over R28 billion over the last 13 years are a testament to this fact. Changes in the aviation business have overtaken it. This is the basic problem it faces. For long, this reality has been masked by the endless government bailouts, north of R16.5 billion in the past decade alone. Without these bailouts, South African Airways would long have ceased to exist as a business entity," said Munzwembiri.

Munzwembiri highlights other key issues plaguing the airline. As part of the business rescue programme initiated to try to save the airline, a proposal put forth is to cut all domestic routes except Johannesburg and Cape Town, in addition to other international routes. However, the government opposed this proposal, notwithstanding the fact that the business rescue practitioners saw this measure as key to ensuring the long-term survival of the airline. Another major factor is the cost structure of South African Airways brought about by overstaffing, and rising jet fuel and fleet management costs. For example, the average employees per passenger at South African Airways is around 200, against an international benchmark average of 100. This obviously means the airline must implement drastic staff cuts. However, this is very likely to be opposed by the unions and the government, which again brings us back to the issue of government interference in the airline's management.

Can South African Airways make a comeback?

Can the South African Airways be salvaged from its current predicament? Guy Leitch is of the opinion that it can be done. "There are plenty of examples of an airline being saved from a similar predicament," says Leitch. "The first thing is to identify the fact that South African Airways is a business like any other business, that is it has got a top line, a cost to sales, and other overheads. All it needs to do is get the figures in the right proportion and it's not difficult." According to Leitch, South African Airways is still quite capable of turning over revenue of around R20 billion to R25 billion per annum.

"It needs to get its cost to sales correct and which is largely happening with the upgrade to a relatively modern and young fleet of A350s, the new A330s and even A320s. Thereafter, what it needs to do is to tackle the fixed costs, especially the higher overheads. Get those things in line – which is not difficult – and the airline can be turned around," said Guy Leitch. But, he warns that continuing government interference will only put the airline's extinction out of question. "Another thing that is required to get the cost base in line is to fix the malfeasance that has crept into the procurement," said Leitch. Unfortunately, history has shown that politicians cannot keep their hands off South African Airways.

"Despite the glaring evidence that this entity is a black hole that will keep draining the fiscus, the government has kept throwing a lifeline to South African Airways at a huge cost to the taxpayer. The government often cites the need to preserve jobs and to protect the tourism industry as reasons for South African Airways to remain in business. However, the question that begs an answer is, at what cost? Especially, given the quantum of money that has already been spent on this flailing airline. This is money that could have been better spent elsewhere," said Munzwembiri. Munzwembiri said that for the alternative financing arrangements going forward, the recent R3.5billion loan from the Development Bank of South Africa (DBSA) approved in just under five days without the necessary due-diligence checks provided some clues.

"DBSA`s mandate in no way whatsoever allows it to foray into financing entities like South African Airways. But, instead it is meant to fund infrastructure projects that could reduce poverty and inequality. Unfortunately, such critical funding meant for other developmental projects is likely going to be diverted toward propping up South African Airways going forward," says Munzwembiri. According to him, selling minority stakes is also not even a guarantee for survival as evidenced by the recent collapse of Air Italy, which is partly owned by Qatar airlines, although this is a strategy that the airline could pursue.

Why Ethiopian succeeded: A government that doesn't interfere!

The success of Ethiopian Airlines can be attributed to two factors that clearly distinguish it from South African Airways: clarity of vision and non-interference from the government in day-to-day operations. In fact, Ethiopian Airlines achieved its Vision 2025 targets in 2018 itself and is now working toward realising its Vision 2035 goals.

“The key to success for Ethiopian has been the approach of the Ethiopian government: In spite of government ownership, Ethiopian has been operating its day-to-day business independently as a commercial entity, further helped by competent leadership and well-trained staff, who are held accountable for their actions,” Dr Sabine Reim, senior vice president, airline network strategy at InterVISTAS, a global aviation, transportation, and tourism consulting company told **International Finance.** She highlights a clear distinction with South African airways which is the key: although the government is the owner of the airline, it is not the manager of the business.

Ethiopia’s geographical location helped it in no small measure to emerge as a hub connecting Africa with the Middle East, Asia, and Europe. Addis Ababa has become a hub, where it is able to attract and transfer much more traffic, particularly from Asia moving on to the American continents. While exploiting Addis Ababa as the hub gave Ethiopian a first-mover advantage, the advantage was turned into a success factor through a government policy that enabled an efficiently planned and coordinated aviation sector while allowing the national carrier to keep a commercial focus on day-to-day operations, said Dr Reim. “This is effectively a brief to fulfil a national strategy sustainably,” she added.

Ethiopia is in a much more natural hub position for the African continent, compared to South Africa, and this makes a big difference for travellers, Marcel Langeslag, director of aviation, Netherlands Airport Consultants (NACO) told **International Finance**. “Ethiopian Airlines has a relatively young and fuel-efficient fleet. It has also partnered effectively with other African airlines to create a feeder network serving their hub in Addis Ababa,” he added.

Another factor that distinguishes Ethiopian from South African Airways is the way the two countries approach the rights of foreign airlines over their airspace and airports. The Ethiopian government has provided intense protection to its own airline. It is extremely difficult for other airlines to get landing rights in Addis Ababa as well as third and fourth air freedom rights that are essential to fly to other places in Ethiopia and operate in Ethiopian airspace. “The government is very jealous in protecting Ethiopian air rights and this is an advantage for the airline,” Guy Leitch said.

The hub of African aviation seems to be shifting east

Will South African Airways be grounded after March 31? A more likely scenario is that a stripped-down, leaner version of South African will continue to fly while shifting some of its local routes to regional airline Mango Airlines. But South African’s ability to boast of bringing the world to Africa and taking Africa to the world is practically over.

With the decline of South African and the rise of Ethiopian, has the hub of Africa shifted to the east from the south? Dr Sabine Reim told **International Finance** that South Africa remains a very important economy not only in Africa, but also globally, with very unique trade links. This is notably demonstrated by relatively large demand to and from South Africa relative to other African countries, including Ethiopia. However, its very southern location lends itself more to a supporting a hub with domestic connectivity and airports as end-points in itineraries. At the same time, Ethiopian has capitalised on its location, essentially competing with European and the Middle East carriers for inter-continental traffic as a first mover, exploiting the vacuum of an efficiently run airlines in Africa.

South Africa is still the largest aviation market on the continent. It has a large domestic market and is a popular destination for tourism and business travellers. Addis Ababa, on the other hand, is primarily a transfer hub. “Air traffic growth in East Africa has been particularly strong over the past decade and looks set for continued growth. Countries such as Ethiopia, Rwanda, Tanzania and Zambia are all investing heavily in their airport infrastructure and national carriers. It seems that the centre of gravity of African aviation is shifting from south Africa to east Africa,” Marcel Langeslag of NACO told **International Finance**.

Dr Sabine Reim of InterVISTAS told **International Finance** that for a competitive advantage in future, Ethiopian might need the newly announced Absera Airport. “In Africa, the growth and ambitions of RwandAir will see a brand-new hub with a growing network opening in Kigali within the next few years, and thus more competition for Ethiopian’s intra-African as well as core inter-continental connecting passenger base. A competitive hub will be key for Ethiopian not only to maintain its current position, but also to execute its long-term growth strategy,” added Dr Reim.

Who will bring the world to Africa? Ethiopian Airlines will

Africa has more than one-tenth of the world’s population but it share of global air travellers is a mere 2.5 percent. Although the global aviation industry faces Covid-19-led instability and certain aviation markets are staring at a decline, Africa could become the next growth market for global aviation considering the increasing need for connectivity and the addition of new fliers.

In fact, according to IATA, in 15 years, Africa could see an additional 192 million air passengers a year which in turn could lead to a total of 303 million passengers travelling in and out of Africa. The opportunities to increase connectivity within Africa are also high. For example, the majority of travellers travelling to Kinshasa in Congo from Accra in Ghana have to rely on a connecting flight. Similarly, there are no direct flights between Abidjan in Ivory Coast and Johannesburg in South Africa, despite the cities being centres of commerce and business in Sub Saharan Africa.

Ethiopian Airlines’ most ambitious project is the recently announced $5 billion mega airport which it intends to make the hub of Africa. Economically, Ethiopia is on a relatively strong footing in Africa to execute such a project. “Ethiopia has much going for it when compared to other African countries. It has myriad economic opportunities and solid domestic market potential. It also has low corruption, a government that is committed to inclusive growth and has shown a demonstrated resolve and persistence in developing the country,” Frans Van Schaik, chairman and CEO of Africa Asset Finance Company (AAFC), a company which provides asset-backed lending services and has invested in the continent, told **International Finance**.

AAFC’s subsidiary Ethio Lease recently won the first financial services licence given to a foreign-owned company in Ethiopia. Van Schaik finds hope from the fact that Ethiopia has the experience of executing mega projects of strategic national interest like the Great Renaissance Dam. But, he admitted that there were two conditions that needed to be met for the project to succeed – reducing the control of the bureaucracy and finding ways to finance the project itself. In this regard, Van Schaik says, “I have no doubt that there will be plenty of takers should the opportunity be offered to international investors to participate in a PPP (public-private partnership), or BOT (build operate transfer), deal especially as and when the government relaxes currency controls.”

The continued success of Ethiopian Airlines and the liberalisation of the Ethiopian economy can be important catalysts for the further development of Addis Ababa as a hub – not just for travel and air cargo, but also for tourism, trade, business services and, even financial services, said Frans Van Schaik of AAFC.

Perry Munzwembiri added that to the extent that the airline anticipates growth in its traffic volumes, the planned mega airport will be a worthwhile venture, especially when viewed through a long-term lens. Also, Bole’s capacity is being stretched. “Bole`s capacity is likely to come under pressure, especially as Ethiopian Airlines seeks to compete with Middle Eastern airlines. There will likely also be issues with the time required to complete the project as well as the ultimate cost of the project. That said, benefits are certain to accrue in the long run,” he added.

What is highly likely is that Ethiopian Airlines will continue to dominate other African airlines into this decade and possibly into the foreseeable future given its sound management and robust vision. The airline is expanding all over Africa by moving very aggressively into new markets, entering into joint ventures with other African airlines, or buying majority stakes in struggling African airlines. It has a business model that allows it to spread its wings to West Africa, which is absolutely essential because the West African airline market is characterised by the universal failure of all its airlines, even the privately-owned ones.

“We can see Ethiopian continuing to grow aggressively. For instance, it is joining up with ASKY Airlines, and also down south it is joining up with airlines in Malawi and Mozambique. Along with expansion, its sound management practices and the government’s positive role in protecting the airline will ensure that the airline will keep its dominant position among African airlines,” said Guy Leitch. “Compared with other African airlines, Ethiopian Airlines is rightly positioned to take over the role that South African Airways used to claim as its own in its marketing, which is to bring the world to Africa and take Africa to the world,” added Leitch.