



February 2019 Report

Perceptions from the Middle Kingdom

Impending Major Changes in PRC Aviation Industry Organization and Structure

Fundamental PRC government directed changes have already begun that will reorganize and restructure the entire Chinese aviation industry in ways that could not be replicated in other major countries. The presumed intent is to consolidate and streamline the industry in order to make it more globally competitive.

The first step, which is already underway, is the rotation of existing top leadership (i.e., chairman and CEO level) among the major airline groups, related government agencies, and the aviation manufacturing industry. To this end, an existing major airline CEO might be reassigned to the same position in another "competing" airline, or to take a senior position in the CAAC (the PRC aviation regulatory agency equivalent to our FAA, but with far more de facto power), or to run an aircraft manufacturing organization or program. Similarly, such rotation may also occur between top airline, government agency and industrial positions and the Communist Party Secretary positions in all such organizations, which exist in every organization and agency and are of equivalent level and stature to the top leadership positions. All of this would consolidate and streamline the industry far beyond what was accomplished by its last major reorganization a decade ago, which merged existing local and provincial airlines into the current three major groups under the "Big Three" state-owned airlines.

Something of this nature would obviously not be feasible in any other major country with a significant aviation industry. In the US, the equivalent scenario would be to rotate the heads of United, Delta and American with each other, or any one of them with the Director of the FAA or the CEO of Boeing. Concerns regarding, for example, proprietary competitive and/or financial data aren't a factor, because those issues ultimately reside at the top government level rather than with the respective corporate enterprises. By the same token, the fact that a particular leader's primary expertise and experience might lie in the operating side of aviation rather than in the manufacturing side, or vice versa, and would therefore seem to be less compatible with a new position on the opposite side, wouldn't be as compelling in a system where the major industry-wide decisions are still made on a collective basis at the national level. Moreover, the concept of having a resident national ruling party official in every commercial organization, with stature and influence equivalent to that of the top leadership, simply would not translate elsewhere in any case.

While this kind of senior personnel cross-pollination among major state-owned enterprises and government agencies might seem to invite a hopeless quagmire of bureaucratic infighting between such enterprises and agencies in a quest to obtain favored candidates, that's probably

not the issue in China that it would be elsewhere. While the main government agencies with cognizance over the PRC aviation industry are the Civil Aviation Administration of China (CAAC), and the National Development and Reform Commission (NDRC), the separate agency with authority over personnel issues is the State-Owned Asset Supervision and Administration Commission (SASAC), in effect the "HR Department" for agencies dealing with state-owned assets such as commercial aircraft. An arbitrator thereby exists to resolve any such bureaucratic conflicts regarding top-level personnel transfers.

So, what is the purpose of this major transition? While the answer to that is of course necessarily speculative, one recurring theory is that it's to ultimately develop and deploy a Chinese "super carrier" airline to dominate global aviation by simply overwhelming the competition. While achieving that objective would of course take time, that's not the detriment in China that it would be in western countries, nor would the pressure for such a carrier to show near-term profitability carry the same weight among competing determinative factors that it would elsewhere. Other factors would also need to be addressed in the course of such an undertaking, such as, for example, the issue of Hainan Airlines, which approaches the majors in size but is not part of any existing group, and which is experiencing significant financial problems due to a number of internal and external factors. An efficient national megasystem of the type envisioned by this theory likely wouldn't tolerate an outrider of that magnitude, which would therefore have to be dealt with during the formative process.

Although how much of this perceived trend in fact materializes, and how soon, of course remains to be seen, the wheels are beginning to turn. We will continue to monitor progress and developments and update this report as and when appropriate.

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