

EDITORIAL +44 (20) 8652 3842

Quadrant House, The Quadrant, Sutton, Surrey SM2 5AS, UK
Fax +44 (20) 8652 3840 email flight.international@rbi.co.uk

Editor Murdo Morrison
+44 (20) 8652 4395 murdo.morrison@rbi.co.uk
Editor's PA Debra Warburton (maternity leave)

Acting Editor's PA Francesca Everett
+44 (20) 8652 3835 francesca.everett@rbi.co.uk

News Editor Emma Kelly
+44 (20) 8652 3096 emma.kelly@rbi.co.uk

Commercial Aviation Editor Max Kingsley-Jones
+44 (20) 8652 3825 max.kingsley-jones@rbi.co.uk

Defence Aviation Editor Stewart Penney
+44 (20) 8652 3834 stewart.penney@rbi.co.uk

Operations/Safety Editor David Learmount
+44 (20) 8652 3845 david.learmount@rbi.co.uk

Business Editor Alexander Campbell
+44 (20) 8652 3990 alexander.campbell@rbi.co.uk

Business & General Aviation Editor Kate Sarsfield
+44 (20) 8652 3885 kate.sarsfield@rbi.co.uk

General Reporter Justin Wastnag
+44 (20) 8652 3863 justin.wastnag@rbi.co.uk

Technical Reporter Michael Phelan
+44 (20) 8652 3843 michael.phelan@rbi.co.uk

Spaceflight Correspondent Tim Furniss
+44 (1237) 471960 tim@spaceport.co.uk

EUROPE/MIDDLE EAST

European Editor Christina Mackenzie
+33 (1) 64 23 68 89 christina.mackenzie@rbi.co.uk

Israel Correspondent Arie Epqzi +972 (3) 941 3132

Middle East Correspondent Gerald Butt
+357 22 771 967 gbutt@spidernet.com.cy

AMERICAS

Washington DC Office Fax +1 (703) 836 8344

Americas Editor Graham Warwick
+1 (703) 836 3448 graham.warwick@rbi.co.uk

East Coast Editor Paul Lewis
+1 (703) 836 3084 jpaul.lewis@rbi.co.uk

West Coast Editor Guy Norris
+1 (949) 252 8971 Fax +1 (949) 252 8972 guy.norris@rbi.co.uk

Brazil Correspondent Jackson Flores Jr
+55 21 2439-6062 Fax 00 55 21 2349-6090 tubar@uof.com.br

Canada Correspondent Brian Dunn

ASIA/PACIFIC

Singapore Office Fax +65 338 6171

Regional Managing Editor Nicholas Ionides
+65 6434 3311 nicholas.ionides@rbi.co.uk

Deputy Asia Editor Andrew Doyle
+65 6434 3309 andrew.doyle@rbi.co.uk

Regional Reporter David Fullbrook
+65 6434 3314 david.fullbrook@rbi.co.uk

Australia Civil Aviation Correspondent Paul Phelan
+61 (7) 4053 2791 Fax +61 (7) 4053 3003 pdphelan@optusnet.com.au

Australia Military Aviation Correspondent Peter La Franchi
+61 (0) 419 246 620 Fax +61 (2) 6231 2795 nulka@ozemail.com.au

EDITORIAL PRODUCTION

Group Production Editor Graeme Osborn +44 (20) 8652 3828

Group Art Editor James Mason +44 (20) 8652 4994

Chief Sub-Editor Chris Thornton +44 (20) 8652 4997

Deputy Production Editor Jackie Thompson +44 (20) 8652 3850

Sub Editor Megan Turner +44 (20) 8652 3848

Photographer Mark Wagner +44 (20) 8944 5225

Senior Technical Artist Giuseppe Picarella +44 (20) 8652 8054

Editorial Artist Tim Brown +44 (20) 8652 8043

WWW.FLIGHTINTERNATIONAL.COM

Webmaster Sheena Buchanan +44 (20) 8652 4432

SUBSCRIPTIONS +44 (1444) 445454


rbi.subscriptions@rbi.co.uk

THE FLIGHT COLLECTION

kim.hearn@rbi.co.uk

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 Reed Business Information

Temptation island

Qantas's and Virgin Blue's duopoly of the Australian domestic market may persuade them to abandon aggressive mutual competition

Just in case any more evidence was needed to demonstrate exactly how prettily Qantas and its upstart rival Virgin Blue are sitting in the Australian domestic market, the flag carrier last week revealed a 134% increase in annual pre-tax profits from domestic operations.

The question now is whether the two airlines will be able to resist the temptation to abuse their market dominance by no longer competing quite as vigorously, or whether yet another would-be new-entrant will be unable to resist the urge to launch a fresh attempt to break into Australia's domestic market.

On the face of it, Qantas and Virgin Blue look set to achieve the ultimate duopoly in the wake of Ansett's collapse. The regulators are happy because Australian travellers get to sample the thrills of no-frills flying. And punters can still shell out more to get in-flight service on Qantas if they want to, or use the full-service airline to connect to long-haul flights.

Qantas and Virgin mostly compete head-on, but in many ways do not. Virgin will get some price-conscious business travellers, but it will also tend to generate new traffic from the ranks of those who would not previously have been able to afford to fly frequently – or at all. Qantas will continue to target the frequent international traveller as its core market, because its long-haul operations have traditionally been even more profitable.

Perhaps the Australians have discovered a formula to rescue the airline industry from a death spiral of over-vigorous competition, senseless pursuit of market share and falling yields. This duopoly must be the envy of struggling carriers in Europe and North America.

Unfortunately, Australia is in many ways a unique market – and even so the status quo might not last much longer.

The country's domestic market is far too lucrative and important to be ignored by other would-be players. It now appears certain that Star Alliance members, probably led by Singapore Airlines, will do something to re-establish their presence, following the collapse of Ansett. But while the entry of a third strong competitor might destroy everyone's chances of turning a profit, the alternative could be every bit as unpalatable.

Given the relative lack of direct competition between Qantas and Virgin Blue because of the different products they offer, it is difficult to see how in the longer term the pair can have any good reason to continue competing vigorously on price. Australians may notice the average cost of their air fares gradually rising.

Qantas will have to tread carefully if it wants to avoid regulators blocking its ambitions for linking up with Air New Zealand through the acquisition of a minority stake.

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For the good of all

After five years of moving in the right direction, Star Alliance appears close to achieving one of its main ambitions – joint procurement of systems and equipment. Although Star has been purchasing fuel and other general supplies for some time, its strategic sourcing agreement with Rockwell Collins for avionics and in-flight entertainment (IFE) systems is a clear sign that Star still believes it can generate cost savings through bulk buying and the simplification of its supplier base in every aspect of its operations.

But is the alliance's long-stated ambition to elevate its joint purchasing strategy

to the ultimate level – the acquisition of new aircraft – achievable? It's hard enough for 14 carriers to agree on the same avionics and IFE specifications, but agreeing a common specification for the platforms those systems are going to fly on is a quantum leap in co-operation and concession. Even Star chief executive Jaan Albrecht concedes this is an ambitious task and any joint deal is at least five years away.

But how realistic is this? In the past, aircraft manufacturers have pushed for airlines to agree to common cabin configurations to reduce production cost. And the dream was achieved 30 years ago by

four European flag carriers when determining the specification of their McDonnell Douglas DC-10 fleets. Austrian Airlines, Sabena and Swissair also achieved the goal in the 1990s with an Airbus A320 deal through their European Quality Alliance.

But the cost benefits will have to be huge to persuade 14 airlines to relinquish the individualism of their cabins or the ability to negotiate additional price reductions by playing one engine supplier off against the other.

Time will tell whether the bond that ties Star members together is strong enough to achieve the ultimate goal.

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