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ASSESSMENT FOR PRIVATIZATION PROSPECTS
ALIA — ROYAL JORDANIAN AIRLINE

THE HASEMITE KINGDOM OF JORDAN

REPORT BY

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1750 New York Avenue, N.W.
Washington, D.C. 20006

Project No. 17

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Prepared for the
BUREAU FOR PRIVATE ENTERPRISE
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ASSESSMENT OF PRIVATIZATION PROSPECTS

I. BACKGROUND AND PURPOSE OF THIS REPORT

The Government of Jordan has been exploring the prospects for privatization of a number of Jordanian industries, including ALIA - The Royal Jordanian Airline, which is now 100% government-owned.[1] An initial survey was conducted by the Center for Privatization, a Washington, D.C. consulting firm. The following conclusion was contained in the Center's report.[2]

> "Considerable progress toward ultimate sale of shares has been made by ALIA - The Royal Jordanian Airline, which is planning the refurbishing of its image and the elimination (refinancing) of its foreign debt (guaranteed by the GOJ) through sale and leaseback of its aircraft with the aim of increasing its capital and improving its capital structure. It is recommended that it move forward with this program even though the current depressed capital markets may preclude full privatization for the time being. The Company's strong leadership gives confidence that the process can be carried out."

This report contains the results of a more detailed, technical review of ALIA's operations. The objective is to provide an assessment of ALIA's viability as a private company.

An evaluation of ALIA's marketing posture with respect to the dynamics of international aviation has been of primary concern. In addition, an assessment of ALIA as a private enterprise has been conducted. This has included an evaluation of its capital assets, its financial needs, its relative efficiency, and its market plans.

The report is based on a lengthy interview of top ALIA officials, a review of internal ALIA documents, and publicly available statistics for selected international airlines. No attempt has been made during this review to assess the way in

[1] As part of a new marketing campaign, ALIA - The Royal Jordanian Airline has recently started to call itself simply The Royal Jordanian Airline. The term ALIA has been retained in this report.

[2] The Center for Privatization: Survey of Initial Prospects for Privatization in the Hashemite Kingdom of Jordan, by Alexander C. Tomlinson, Anthony J. Shepard, Joel R. Washington, July 28, 1987, p.1.

which internal ALIA documents have been assembled or presented or to evaluate internal management practices and systems.

II. EXECUTIVE SUMMARY

Based upon an evaluation of ALIA's operating environment, its business plans and current operations, the company appears to be a prime candidate for privatization. The primary reasons for this conclusion include the following:

o There is a good business climate in Jordan which favors open markets and free enterprise.

o The competitive pressures in the international aviation arena are such that the additional operating flexibility and efficiencies that ALIA could be expected to derive would contribute to the carrier's future growth.

o ALIA has been pursuing a credible operating plan, given its market position. It has a solid management team, a well conceived marketing plan, and a modern fleet.

During its development, ALIA has demonstrated an excellent ability to define and develop its markets. However, it still faces serious challenges. Its home market is relatively small, its ability to develop the marketing mass generally considered necessary to reach economic levels of production is limited both by its resources and by aviation agreements between Jordan and foreign countries, and it faces strong competitors throughout its system. None of these challenges are judged to be insurmountable.

ALIA has benefitted in the past from a close relationship with its government insofar as the government has guaranteed the debt incurred to purchase aircraft. To obtain satisfactory aircraft financing, it is likely the vendors will continue to insist on some form of government guarantees.

However, the advantages to ALIA of privatizing will be to provide it with greater control over its future than it currently has as an arm of government. For example, it is generally accepted that government oversight hampers the ability to respond rapidly and creatively to changing market conditions. In addition, greater efficiencies in operations can be expected from a private enterprise than from a public body. These capabilities will be essential to the long-term survival of an international air carrier <u>unless</u> its government commits to on-going subsidies.

In addition, privatization, particularly with substantial employee stock ownership (as envisioned by ALIA management), will provide the airline's work force with the opportunity to share in the airline's future growth and with the incentive to become and remain efficient.

One advantage to the Kingdom of Jordan would be to remove an enterprise from its budget that might otherwise not be profitable over time. In addition, privatization of ALIA would set an example for other industries in Jordan.

The primary disadvantage to the airline is that the security of government support during the valleys of the business cycle would be withdrawn. (Presumably, the government could and would still make the decision to save the airline in the event of disastrous external events). The disadvantage for the Kingdom of Jordan is that, to the extent the airline has been used as a policy arm of the Kingdom, it would no longer be as responsive.

In the opinion of ALIA's management, privatization should be undertaken in phases. The first would be to provide stock for employees and for private placement. The second would be to seek broader distribution for the stock within and outside of Jordan. To accomplish this, new shares of ALIA stock would be issued to broaden the capital base.

This approach would appear to make eminent sense for the following reasons:

- Based on discussions with AID officials and with ALIA management, it appears that the capital markets in Jordan could not absorb the placement of a substantial portion of stock in such a large enterprise in one offering.[3]

- It is unlikely that there would be a broad market for the stock at the present time in international exchanges because of the civil disruption in the region and because the company is not currently earning satisfactory returns.

It was the task of this study to determine whether or not privatization is feasible from the standpoint of airline operations. Before a public sale of stock in the airline, an investment banker would need to assess the possibility of marketing the stock in the region and on foreign exchanges. In addition, it may be necessary to undertake a more detailed review of the company's accounting practices to assure conformity with private sector procedures.

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[3] Because of the "substantial ownership and control" requirements of most aviation agreements, a substantial portion of the stock will have to be held by Jordanian citizens.

III. CLIMATE FOR PRIVATIZATION

A. Privatization - Pros and Cons

Privatization of companies essentially calls for the broadening of private sector ownership (either through sale of stock on an exchange or through private placement of stock) of the equity of commercial operations which have been either wholly or partially owned by government entities. In addition, it contemplates that control of the operations of the newly privatized company will become vested in its owners and managers, rather than in government agencies. Finally, the privatized company is usually expected to compete in open markets, without the benevolent protection of its national government.

Of course, there may be solid justification for some residual governmental regulation of the affected company and/or industry. However, the basic reason for such regulation should be to protect and enhance the operations of the free market.

Most privatization projects, regardless of the country in which they are undertaken, are controversial. Proponents argue primarily that privatization, and the discipline of competing in open markets, lead to efficient operations, thereby creating profits for owners. These efficiencies include the divestiture of government bureaucracy with respect to people and mandates, in addition to the improvement of standard management practices. They believe the public is best served by having its purchasing power sought by private companies competing against each other.

Opponents are primarily concerned, on the other hand, that power, through ownership, will be concentrated in the hands of a few to the detriment of the many. They argue that private companies will raise prices unreasonably in order to provide a higher return for their owners. They are concerned that the drive for efficiency will mean a loss of jobs and believe a private company will exploit markets when rents are high as well as avoid those where public need may be greatest if rents are low.

These arguments, and many more, have been enunciated in Jordan with respect to the possible privatization of ALIA. In addition, it is argued that ALIA, being a national flag airline, has no competitors and, consequently, is in a unique position to use abusive power over its "captured" markets.

An assessment of the prospects for ALIA's privatization must be made within this controversial context.

In the opinion of the project team, the competitive environment in which ALIA operates very much limits any opportunity for abuse of a monopoly position primarily because, as will be described, most of ALIA's markets are already served by competitors. Also, to the extent that either domestic or international markets would not be developed by a privatized ALIA, presumably because they lack profitability, it would be more efficient for the Government of Jordan to make an explicit decision that subsidy is warranted "in the public interest."

Also, as indicated later, although ALIA appears to be overstaffed for its present operation, a loss of current jobs is hardly inevitable in view of the opportunities for near and long term expansion of the carrier's operating base. Finally, it is true that there may be some concentration of ownership during the early phase of private placement of the airline's stock. However, as indicated, opportunities to unjustly capitalize on such ownership by artificially raising prices are simply not available in view of the competitive situation. (Indeed, on a worldwide basis, airlines have traditionally reaped relatively low returns on investment).

B. Country Assessment

As indicated in the initial report conducted by the Center for Privatization, the climate for undertaking privatization projects within Jordan is generally positive. There is a strong private sector orientation in Jordan with markets historically being open to free competition from within and abroad. The central government of Jordan is committed to encourage privatization projects where they make economic and social sense. The government is politically stable and can be expected to stay on its committed course.

In addition, the Jordan dinar is a stable currency, with remittance freely permitted, thereby encouraging foreign commercial activities.

Therefore, although economic arguments against privatization are being made, there would appear to be few political or institutional roadblocks to proceeding with privatization.

It must be mentioned that while the internal political climate within Jordan is favorable toward privatization, the external climate is not. Given the scope of this report, no effort has been made to evaluate the effect of political disruption in the region on the attractiveness to investors of ALIA's stock. Needless to say, the risk of external disruption would suggest that returns to investors would have to be very high, particularly to those outside the region who are not acquainted with the details of the airline and its operating environment or who would have no expansive reason for investing in the future of Jordan and its industries.

C. Industry Assessment

On a worldwide basis, the international airline business is populated by companies that are privately owned and publicly owned, with many variations of ownership in between. In addition, governments have typically viewed airline operations as essential to public convenience, economic welfare, and national security. Therefore, the industry has been highly regulated by governments. In addition to fundamental safety regulations, economic regulation essentially takes the form of determining route and capacity allocations and price levels.

In the past decade, there has been a trend toward deregulation of international aviation. The thrust for such deregulation has had several sources. In 1978, the U.S. decided to deregulate its domestic market and subsequently pressed to "export" its policies. Traditional free trade countries such as the United Kingdom, The Netherlands and Germany in Europe, and Singapore and Korea in Asia, elected to follow this lead by accepting substantially reduced regulation in their aviation agreements with the U.S. Other countries have moved in the direction with somewhat less speed and enthusiasm. Finally, the European Community countries are headed in the direction of deregulation by the force of the Treaty of Rome, which mandates open trade and competition among the participating countries.

Within the international aviation field, the judgment is increasingly being made that state enterprises have few incentives to become and stay efficient relative to their competitors (with many of the inefficiencies being imposed by governments themselves) and will increasingly become a drain on public coffers. As a result, numerous countries are moving to privatize their national carriers. This includes the United Kingdom (British Airways), Japan (Japan Airlines), Singapore (Singapore Airlines) and Canada (Air Canada), to name just a few.

It is safe to say that the international environment is going to become more competitive. There will be a high premium on cost control and efficiency. It is within this environment that ALIA must compete for international business.

IV. ENTERPRISE ASSESSMENT

A. Brief History of the Carrier

Subsequent to World War II, air service to and within Jordan was offered by a number of joint-interest companies. In the early 1960's, Jordan was served by Jordan Airlines, which was owned by Middle Eastern Airlines (MEA). It was generally felt up to this time that Jordan could not support an airline of its own.

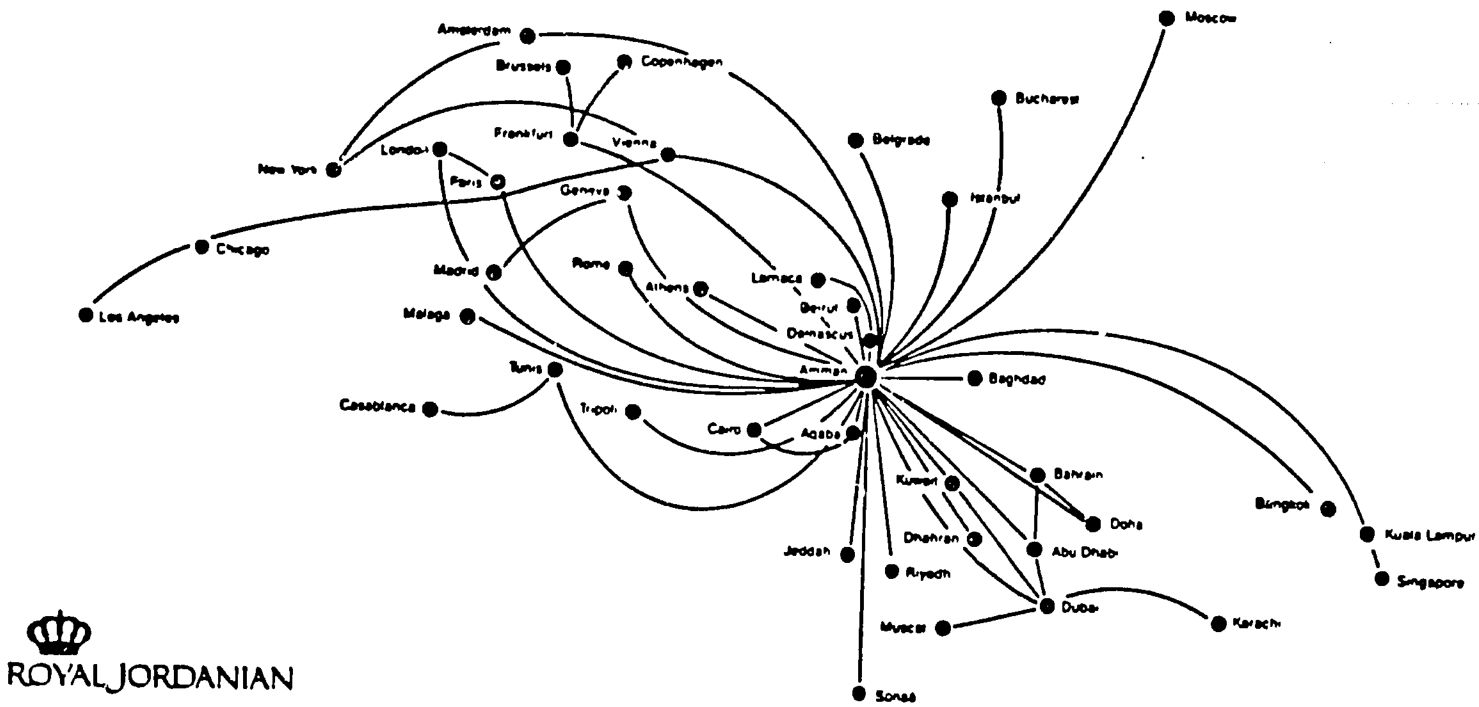
In 1964, ALIA was started under the direction of its current Chairman, Mr. Ali Ghandour, with the King of Jordan's explicit support. ALIA consisted of one airplane which was owned 50% by government and 50% by private families. The company prospered reasonably well until the War in 1967. At that time, the carrier lost two of its four aircraft on the ground in Amman. Given the subsequent loss of confidence in the carrier's ability to remain profitable, it was purchased entirely by the government, with Mr. Ghandour remaining as its Chief Operating Officer.

Since that time, ALIA has expanded and prospered. At the time of this review, the airline had 17 jet aircraft. It has two more aircraft scheduled for delivery in 1987. ALIA serves 43 cities on four continents. The company has been profitable for 8 of the 11 years, 1975 - 1985, although prospects for a profitable 1986 were uncertain. An operating loss seemed likely because revenues were below budget.

B. Competitive Environment

1. International Aviation Agreements

While ALIA operates some scheduled service solely within Jordan, it must be viewed primarily as an international carrier. Within this context, to suggest, as some of the opponents of privatization do, that it does not have any competition is simply erroneous. ALIA carries the Jordanian flag to 42 foreign destinations and competes against 22 foreign flag carriers for traffic to/from Jordan. In addition, ALIA must compete for traffic on sectors between foreign countries (where it has the rights).



Such competition is admittedly limited by government agreements, commonly referred to as "bilateral air transport agreements" because they are typically negotiated between two countries. Among other things, these agreements specify route rights and provisions for adding capacity on the defined routes, and set up procedures for setting prices. Since all foreign governments have an interest in protecting the economic viability of their carriers, these agreements often severely limit the capacity (frequencies and/or seats) that an airline can offer on any one route[4] and the ability to offer low, or "promotional" fares.

Such government restrictions, while designed to protect carriers from cutthroat competition, inevitably result in inefficient operating conditions for the carriers of both parties to the agreement. For example, in most instances, ALIA is limited by these agreements to operating less than daily service to its prime developmental markets (e.g. Jeddah [6 frequencies per week], Rome [3], London [4 in winter, 6 in summer]). Assuming the traffic warrants daily frequencies, this type of limitation results in less than desirable marketing coverage,

4 Most of ALIA's major markets are affected by such restrictions.

inefficient scheduling of aircraft, and use of employees.[5] Passengers also worry about delays resulting from less-than-daily service because a missed connection or flight cancellation can leave them stranded for days.

In addition to facing protectionist sentiments on the part of foreign governments around the world, Jordan is faced with the fact that its home market is not large. Therefore, the economic values for trading away restrictions imposed on it by aviation partners, that is by trading access between Jordan and most foreign countries, work against Jordan.

Nevertheless, Jordan has aggressively sought rights from foreign countries by offering agreements containing little or no restrictions on foreign competitors. ALIA has consistently demonstrated its willingness to accept competition at its "hub" in Amman in return for the opportunity to compete in foreign markets. While this approach is to be commended, it is not without risk. As conditions improve, foreign competitors as well as ALIA will take advantage of some of these rights. This will put a high premium on efficiency and marketing ability.

2. Markets

As demonstrated on the ALIA Route Map, Amman is well situated geographically to become a Middle Eastern hub for flights within the regional area and from Europe and Asia. ALIA and Jordan serve as bridges for access between Europe and a number of Middle Eastern countries. However, ALIA has competition for this traffic from many of the European airlines via other hubs and from some of the strong Middle East airlines such as Saudia and Gulf Air.

Beirut was the major connecting point for the Middle East but lost this status as a result of civil disruption. It is not likely that it could regain its strength even in the event of peaceful conditions if only because Amman has gained, and will continue to gain, in attractiveness in the meantime.

In the past, some efforts have been made to promote other Middle Eastern points as hubs and they have not generally been successful. Civil disruption, religious preferences or

[5] It is expected that the delivery of the planned A-310 aircraft will ease this problem insofar as the aircraft will replace the current operations of an L-1011, thereby reducing the number of seats being offered on any single frequency. Under some of Jordan's bilateral agreements, seat limitations are imposed and, thus, the use of the smaller aircraft might permit an increase in the number of frequencies that can be operated.

antipathy, economic and business conditions, and undesirable weather conditions are a few of the reasons why cities such as Athens, Cyprus, Damascus, Cairo and Baghdad are not as ideally situated over the long term as Amman. Tel Aviv could never be considered as an entry point for the rest of the Middle East.

Cairo, Jeddah, Kuwait, Baghdad, and Beirut are readily accessible from Jordan and already well served by ALIA. It is clear that ALIA has made a major effort, with the government's support, to promote Amman as both a destination and a through point in the Middle East.

Nevertheless, there are limitations for Amman as well as a Middle East hub. It has a relatively small population base. It also does not have a large number of regional headquarters for firms doing business in the Middle East. The absence of oil makes it less attractive to oil companies that might otherwise value its location and open business conditions. In the future there may be regional competition for Amman and Jordan. However, it is not possible to predict how that competition will settle out.

For traffic from the United States and from Western Europe and destined to points in the Middle East, there is also competition from other existing hubs located outside the region. For example, a passenger destined to or from a Middle East point has the opportunity to make a nonstop-to-nonstop connection in Europe at Paris, Zurich, London, Rome or Frankfurt. A passenger destined to or from Western Europe can use an array of nonstop services between the major European points and the various Middle East points.

In sum, ALIA, with the help of the Jordanian government, is making every effort to promote Amman as a Middle Eastern hub. ALIA is attempting to exploit niches while also building up Jordan as an attractive hub and destination. It is possible that this strategy will succeed, particularly if the political environment in Jordan remains stable and a tourism and business-oriented infrastructure is developed in Amman. However, the success of the strategy is contingent upon continued weakness of other locations and the availability of niches relative to other routings for Middle East traffic.

3. Competitors

ALIA competes against some of the strongest airlines in the world. The table below shows the airlines serving Amman and their weekly frequencies.

European Airlines/Cities	Frequencies per Week Foreign/ Amman[6]	ALIA/ ForeignCity[7]
Alitalia/Rome	2	3
Air France/Paris	2	2
British Airways/London	3	5
KLM/Amsterdam	2	2
Olympic/Athens	2	4
Lufthansa/Frankfurt	5	4
Swissair/Geneva/Zurich	2	3
Turkish Airlines/Istanbul	1	4
Total Europe	19	27
Eastern Europe		
Aeroflot/Moscow	1	1
Yugoslav/Belgrade	1	1
Romanian/Bucharest	2	1
Interflug/East Berlin	1	0
Asia		
Pakistan Int'l/Karachi	1	1
Regional Based Airlines		
Gulf Air	5	12
Emirates	2	7
Kuwait Airways	7	7
Egypt Air	7	14
Libyan Arab Airlines	2	2
Yemenia	1	1
M.E.A.	3	
Iraqi Airways	6	7
Saudia	6	10
Total Regional	39	60

European airlines are particularly strong competitors for ALIA because of their home market power, their international reputations, and their ability to flow traffic over their home country hub to Amman. Most of these carriers also provide direct

6 Frequencies supplied by ALIA.

7 ALIA frequencies per July 1986 Official Airline Guide Worldwide edition.

service from their home countries to the Gulf points and to Saudi Arabia.

In considering ALIA's regional competition, it must be recognized that ALIA faces several very strong and well financed airlines that are larger and have important traffic destinations as their "home ports". Gulf Air and Saudia are both strong companies with substantial backing. In addition, Kuwait Airways is a force in the region.

ALIA is a smaller carrier than many of its competitors, but it is not without strengths in meeting this formidable competition. ALIA's approach to these problems is detailed in the market plan section.

4. Regional Distribution of Traffic

The following table shows the distribution of passengers on ALIA's system by region. If Revenue Passenger Kilometers were used, the importance of these regions would shift toward the Europe and North American markets, reflecting the longer hauls.

REGIONAL PERCENTAGE DISTRIBUTION OF PASSENGERS

Region	1985 Percentage
Middle East	30.3
Europe	24.4
Gulf	17.8
North America	12.1
Far East	7.3
Domestic	5.4
North Africa	2.7
	100.0%

Almost half of ALIA's traffic is generated on routes in the Middle East and the Gulf. Data was not available at the time of preparation of this report on ALIA's share of individual markets.

ALIA has assigned a high priority to the North Atlantic as reflected in the resources dedicated to it. This is also its most competitive market. In 1985, ALIA carried 155,600 passengers. This would give it less than a 1% share of the market. Because its marketing presence is not great, ALIA would have to market its services through volume operators. This tends to generate lower yield traffic, which puts a high premium on being a low cost carrier.

C. Market Plan

1. Passengers

ALIA has undertaken to develop a marketing plan that covers all aspects of the Jordan travel market. The plan addresses the strategic interests of the country and may have been formulated with that in mind. In addition, the plan has made ALIA a visible force in international aviation. Given the country's size and the limited local industry and natural resources, this is a remarkable achievement.

The market plan has five aspects as the team views it.

1. **A Hub and Spoke Airline Operating as an International Entry Point for the Middle East.** ALIA provides a hub and spoke connecting pattern to the various Middle East points via Amman. This is a similar concept as used by U.S. domestic operators, although traffic flows and flight frequencies are much lower than in a traditional U.S. system.

2. **Tourist Access to the Holy Land and to the Various Religious Sites.** ALIA has good access to the major religious sites in the region. It can access Jerusalem via surface transportation. ALIA is probably the principal competitor of El Al for this traffic. Entry via Tel Aviv does not provide the same access to sites as does Amman.

3. **Tourist Access to the Resorts on the Red Sea.** Jordan does not have the resources in terms of resorts that some countries do. It has moved to exploit those that it does have and ALIA is the key to this program.

4. **Services for returning Jordanians.** Many Jordanians work outside the country and ALIA serves as the transportation system to allow them to return for home leave.

5. **Local Services.** There is a small market for local business travel between Amman and other Middle East points and to Europe. This market tends to be higher yield and ALIA serves that market.

ALIA is clearly attempting to exploit all known sources of traffic. In addition, ALIA is mounting its marketing plan with considerable clarity of definition. Therefore, it can tailor its services and fares to identifiable segments of its total market. It is also able to use its subsidiaries (hotel, travel agent, domestic charter operations, duty free shops, etc.) to enhance its services to each of its markets.

It must be noted that this segmented plan has been developed on a very small population base. Usually the larger the local traffic and the larger the business destination, the easier it is to exploit a hub by mounting a substantial number of frequencies. ALIA has worked with less than ideal circumstances and has still made substantial progress in terms of profitability and growth.

In sum, despite a limited traffic base, ALIA has developed a sophisticated market plan and seems to be aggressively pursuing all elements of that plan. The extent to which the plan will be successful in the long run depends on the ability of the company to develop each of its markets to its full potential. Once out of this developmental phase, however, ALIA will still have its job cut out for it because, as is the case today, it will be competing against much larger airlines. In addition to possibly having more staying power than ALIA does in a downturn, these carriers could also decide to actively exploit Jordanian traffic bases if the market shows signs of substantial growth.

2. Cargo

ALIA's marketing plan for cargo operations was not reviewed in detail during the meeting with ALIA management. ALIA provided some detailed information on its cargo yields and carriage. Clearly, cargo is an important aspect of ALIA's plan for the future. The wide-bodied aircraft in ALIA's fleet make the cargo marketing plan especially important.

3. Pricing

ALIA appears to be following a fairly classic pricing policy. ALIA management divides passenger markets into two basic groups: the "must-go" category and the "dynamic" category.

The former group tends to be a stagnant market insofar as passengers are making essential trips and would travel regardless of price (within reason, of course). This is a high yield market of relatively stable size.

U.S. airlines further subdivide this "must-go" market (for international services) into three additional catagories. These are First Class, Business Class and Normal Economy fare traffic. These passengers place a high value on service and frequency. Because the net fares these passengers pay are 2 - 10 times the net fare of a "dynamic" passenger, this market requires special attention. For ALIA (and other airlines) this market is influenced by general business conditions. A slump in oil revenues in the Middle East could impact this traffic.

The second market category is more dynamic and can be stimulated with lower fares. ALIA is introducing promotional fares as the need is determined but, by restricting the number of seats offered for these fares, is taking appropriate steps to make sure they do not dilute revenues. There is also a lot of price competition for this market. Given the large aircraft flown by ALIA (747's and L1011's), a substantial portion of its seats must be devoted to this category.

It should be noted that, in general, ALIA's fares will be largely dependent on the policies of its competitors. ALIA is predominantly an international carrier and is not a major factor in some of its important markets such as the transatlantic. Therefore, to a large degree, it will have to follow the leader. This is good news as long as it continues to compete against predominantly government owned, traditional carriers because the prevailing interest will be in keeping fares high [8] primarily because costs are high and profitability is marginal.

If the European scene moves toward deregulation with its aggressive competitive outcome, it is likely that ALIA will face downward pressures on its fare structure. Some of this pressure will result from the major U.S. airlines reducing their costs in the transatlantic markets and forcing the European airlines to do the same. There is no reason to believe that downward price pressure will occur in the next year or so, or that ALIA will not be prepared for it when it comes.

D. <u>Operating Performance</u>

1. Introduction - ALIA's Accounting System

ALIA's accounts are maintained in a format which is established as a standard by the International Air Transport Association for its member carriers. Thus, it can be assumed that they are somewhat comparable to other major air carriers'.

Despite the existence of a standard accounting format, it is difficult if not impossible to make comparisons between carriers if only because a variety of adjustments are made between the

[8] IATA carriers have typically rejected the concept that revenues and profitability can be increased by lowering fares with the objective of expanding market size. In the past, the fundamental belief in elastic pricing strategies has been largely held by charter operators and a few inventive scheduled operators, or reserved only for special occasions in limited markets by the large operators. Certainly, the availability of a large variety of fares through sophisticated computer reservations systems (CRS) is unique to U.S. operators.

operating entity and its subsidiaries. These adjustments make the earnings of the airline itself less than completely clear.

Thus, to the extent comparisons are made in this report, they are based on fairly standard measures of performance, for which the IATA format was established. Beyond these operating statistics, the company's own history is the most relevant comparison.

The company's financial accounts are audited by a reputable accounting firm and their accuracy has been assumed for the purpose of this report. Should ALIA move toward issuance of stock on a major stock exchange, it is highly likely that these accounts would have to be prepared for the purpose. This would be particularly true for the U.S. exchanges, which set rigid standards for any listed company.[9]

2. Revenues

As shown in the chart below, ALIA has maintained an impressive growth in revenues since its creation, averaging 22.5% annual growth during the past ten years. High revenue growth has been maintained each year except during the June 1967 war and during 1983 and 1984, when the world's airlines suffered from economic recession. Of course, ALIA was additionally impacted by the politically unstable situation in its region at this time. Nevertheless, despite continued uncertainty and disruption in the region, ALIA managed to increase revenues again in 1985 and is estimated to repeat this performance in 1986, with passenger and cargo revenues estimated to grow beyond the previous record set in 1982.

Among other things, revenue numbers reflect the sale of aircraft, which can inflate otherwise low operating earnings. This certainly was the case in 1985, when two aircraft were sold. However, detailed figures on sources of revenue show that all categories of operating revenue have participated in the general trend described above.

Such revenue growth is not uncommon to fledgling carriers. For example, during the ten year period that ALIA's revenues grew at an average rate of 22.5%, Singapore Airlines' grew at 14.7% and Swissair, a relatively established carrier, experienced a revenue growth rate of 7.97%. However, in view of the fact that ALIA has been confronted by political disruption and has had to develop an awareness of its home market and corporate identity at the same time, this growth is particularly impressive.

[9] British Airways spent many months to reform the company's "standard" accounting system to conform to U.S. Securities and Exchange requirements.

3. Costs

As ALIA has grown, so too have its costs. In fact, until 1982, they almost exactly traced the increase in revenues, averaging an increase of 22.6% per year between 1975-1985. (See below).

Of course, a large portion of ALIA's cost increases would be caused by the aggressive development and expansion program undertaken by the company. However, the characteristics of the ALIA system suggest that, at least at this stage in its development, the company is inherently a high-cost operator. While these characteristics are discussed throughout the report, and are detailed in the section below on "Efficiency," they primarily relate to the operation of a far-flung route system with limited frequencies.

4. Profitability

The company reached steady profitability in 1973 and thereafter improved its profitability through 1982. The year 1983 was a notoriously bad year for all international carriers and ALIA was no exception. ALIA experienced a 4.3% decline in revenues over 1982 but was able to decrease expenditures as well (2.7%), thereby suffering only a slight loss. However, in 1984, ALIA was again impacted by Middle East strife, which caused a 3.9% decrease in revenues. Costs increased by 3.3% over 1983 and, therefore, ALIA's loss widened substantially. In 1985, ALIA was able to reduce its operating loss and earned a net profit largely as a result of the sale of two aircraft.

YEAR	REVENUE JD (000)	+/- %	EXPENDITURE JD (000)	+/- %	BALANCE JD(000)
1975	17,674	74.4	17,340	75.0	333
1976	25,112	42.1	24,929	43.8	182
1977	30,974	23.3	30,752	23.4	222
1978	44,100	42.4	41,624	35.4	2,475
1979	57,715	30.9	55,475	33.3	2,240
1980	80,137	38.9	78,887	42.2	1,250
1981	109.024	36.0	107,131	35.8	1,892
1982	129,547	18.8	128,107	19.6	1,439
1983	123,875	(4.3)	124,603	(2.7)	(727)
1984	119,054	(3.9)	128,758	3.3	(9,709)
1985	134,526	13.0	132,698	3.1	1,828
85/75	AVG.G.R.	22.5	AVG.G.R.	22.6	

5. ALIA Financial Strength[10]

ALIA's current equity capital position was based on an investment of the Kingdom of Jordan. In loss years the equity position has either eroded or there has been recourse to the general reserve account. As a state enterprise, the Kingdom of Jordan is committed to cover any losses. It also guarantees all of ALIA's liabilities.

ALIA's debt to equity ratio is high. It clearly needs more capital to be a viable private sector company. Some new capital will be raised by the public sale of newly issued stock.

Additional capital will be raised by the revamping of the current debt of the enterprise. To clean up its balance sheet prior to privatization, ALIA is preparing to refinance its debt. It plans to do this by sale and leaseback of its current fleet.[11]

Actual value of the fleet is greater than book value. The difference between the sale price and the book value would be an addition to working capital.

In the course of this transaction, ALIA would also be trading high cost fixed rate debt for the lower cost "debt" (operating leases) available in the capital markets today. This is illustrated in the table below.

	Book	Appraised
B727-200A (4)	$ 32.3	$ 43.6
B747-200B (2)	55.1	85.1
L1011-500 (8)	264.9	267.6
	$ 352.3	$ 396.3

ALIA had about $361 million of external (foreign) debt in October of 1986. All external debt would be retired as part of this program. ALIA expects that after debt repayment, its working capital position would be improved by $32-33 million.

[10] The numbers in this section are based on interviews with ALIA management. They have been verified to a substantial degree by review of the 1985 Annual Report. Currency fluctuations account for most of the differences as nearly as can be determined.

[11] In October 1986, when the interviews for this project were conducted, ALIA management had not completed this transaction but were investigating several viable options for doing so.

It is ALIA's expectation that the annual cost of the operating lease payments will be less than the cost of servicing ALIA's debt at the current (high) fixed rates. It is currently paying about $120 million a year in interest and principal on its long term debt. It expects that the cost of the operating leases will run $50-55 million per year. Interest payments based on 12.5% plus margin will be reduced to 9.0-9.5% including margin.

ALIA has two A-320 scheduled for delivery.[12] There will be an operating lease for these two aircraft at a total of $7.5 million per year.

For the years 1987-1989, ALIA forecasts lease (debt) payments of:

1987	$62.5
1988	66.0
1989	73.5

Given ALIA's plan, the step proposed seems to make sense.

The change of the fleet to operating leases does raise some accounting and balance sheet issues. In the U.S. there are accounting issues as to whether certain operating leases have sufficient ownership aspects that they must be carried on the corporations' books. This in turn has balance sheet ramifications. This is a matter that should be reviewed in more detail but it is not a matter that precludes proceeding with privatization. This is an issue of whether the planned capitalization of the enterprise is adequate for its needs.

It should be noted here that U.S. companies are moving toward leasing rather than owning aircraft. In other words, there is nothing inherently unusual about the concept of an airline not owning any aircraft.

The Government of Jordan is now a guarantor of the debt of ALIA. Jordan will still remain a guarantor but the role will be much reduced. It is our understanding that the Government of Jordan will guarantee the payment of the operating lease payments each year as they come due. Thus the guarantee of the government would appear to be lessened to that portion of the lease ALIA cannot pay in any year. It is not clear that the change in guarantee is different in ultimate effect to a lessor or seller. It probably helps the books of the Kingdom of Jordan because only a small portion of the total outstanding debt comes due in any given year.

12 These aircraft have a market value of $60-65 million.

A truly private firm should not require or need government guarantees. On the other hand, for a firm in transition, continuation of a limited guarantee program is not inappropriate. For one thing the lenders/lessors may demand such a guarantee. Without a guarantee, the rates ALIA must pay might be uneconomically high.

There are comparable precedents for continuing government support in the United States. As part of the deregulation legislation, the U.S. Government agreed to continue for a period of years, an operating subsidy program, and an equipment loan guarantee program to make attractive financing available to smaller companies. The operating subsidy was a carryover of earlier mail pay subsidy programs. It was not designed to guarantee any specific service levels. The equipment loan guarantee program was used by airlines such as Air Florida to lower its acquisition cost of equipment to levels closer to those paid by its larger competitors.

6. Efficiency

Revenue and cost figures show the growth of the carrier over time and demonstrate its ability to make a profit. The more difficult task, and the one which provides a better insight into the carrier's chances of success in the long run, is to determine ALIA's efficiency in delivering its services relative to its competitors.

The team sought with mixed success to try to evaluate ALIA's efficiency compared to other international airlines. Unfortunately, the figures which an airline analyst would wish to use, that is, measures of output in terms of cost[13], are not available in a form that could be used without further discussions with ALIA to assure that correct adjustments were being made.

As a result, it seemed only prudent to use operating statistics that, for the most part, can be extracted directly from the IATA formats. Although these figures can also be skewed by accounting decisions, their magnitudes can be assumed to be accurate enough for purposes of this analysis.

13 The key comparisons would be based on cost per available tonne kilometer and cost per revenue passenger kilometer. In addition, the operating cost breakouts by equipment type in the U.S. DOT formats would have been helpful for comparative purposes. It was not possible to adjust ALIA's accounts to be comparable to the data available on U.S. airlines. Data is not available to make comparisons among foreign airlines.

In the best of circumstances these comparative evaluations have some risks. As mentioned above, while airlines use common formats, it is often not possible to easily identify apples and oranges. Of course, the necessity to convert currencies also hampers this analysis.

For purposes of comparison, airlines were selected for geographic location (U.S., Middle East, European, Asia), and known operating characteristics (high versus low frequency, high versus low cost, etc.). In other words, no attempt was made to compare ALIA to all of its competitors, but simply to select known quantities in order to demonstrate approximately where ALIA fits in the scheme of international carrier characteristics.

While the following tables only provide selected insight into ALIA's relative efficiency, they paint a picture that is fairly consistent with what one could extrapolate from the preceding discussion of ALIA's operating characteristics.

The first consideration is ALIA's size relative to its competitors. Size is important for several reasons. First, it provides marketing mass. High levels of consumer and travel agent awareness are difficult to achieve if one is not a relatively "frequent" player. As a corollary, it is obvious that achieving such awareness in the absence of a such presence is a costly proposition. Second, size suggests the ability of an airline to support its basic needs, such as maintenance facilities, computer reservation systems, training operations, and the like.

As the table shows, ALIA is certainly among the smallest international airlines (excluding African airlines from consideration). The only airline serving the region that is close in size to ALIA is Egyptair. Pakistan International and British Caledonian are twice its size. Other competitors are 5-10 times larger.

1985 Enplaned Passengers and Annual Revenues of Selected Airlines

Airline	Enplaned Pax (000)	Revenue U.S.$(000)
Eastern	41,766	4,815,070
American	41,172	6,131,000
TWA	21,079	3,860,696
British Airways	16,938	4,724,000
Japan Air Lines	14,649	4,577,633
Pan Am	13,041	3,090,324
Alitalia	12,749	2,413,440
Air France	12,483	3,353,441
Saudia	10,795	N.A.
Swissair	6,187	2,307,620
Pakistan Int'l	3,839	601,357
Finnair	3,074	N.A.
Gulf Air	2,870	626,320[14]
Egyptair	2,722	449,248
BCAL	2,406	647,152
Kuwait Airways	1,449	443,742
El Al	1,409	N.A.
ALIA	**1,290**	**340,423**
Syrian Arab	476	N.A.

Another comparison that is often used is the percentage of se ts filled because, in general, the achieved load factor is a measure of success in selling the product. Caution must be used in interpreting load factor data, however, because load factor may be a measure of market size as well as of effectiveness in delivering services. The main point to be made is that low relative load factors, by necessity, require that services be delivered at low cost if a carrier is to sustain profitability over time or, alternatively, load factors must be raised to accommodate rising costs of delivering the service (assuming prices are at "fixed" levels by competitive pressures).

In the base year used for this study, ALIA has a lower load factor than many of its major (and probably better known) competitors. Again, given the markets served by ALIA and the competitive situation, a low load factor is not surprising at this stage in the carrier's development. Also, the acquisition of aircraft better suited to serving long, thin routes (see Fleet Plan, below) should help to increase the overall load factor.

[14] Estimated from figures quoted in The Financial Times, October 14, 1986.

A review of ALIA's reports shows that ALIA has a lower than industry average breakeven load factor.[15] This helps, but the average load factor is still a matter for concern.

1985 Average Passenger Load Factors for Selected Airlines

Airline	Load Factor
El Al	71.5
British Airways	68.6
Japan Air Lines	68.0
Air France	67.9
Pakistan Int'l	66.3
TWA	66.0
Alitalia	64.7
American Airlines	64.6
Swissair	64.6
Pan Am	63.0
BCAL	61.0
Saudia	60.7
Eastern	60.3
Finnair	59.2
ALIA	**57.7**
Syrian Arab	57.5
Gulf Air	57.1
Egyptair	56.7
Kuwait Airways	55.0

Another measure of an airline's relative efficiency is employee productivity. There are a variety of measures used to test this, none of which are entirely reliable. However, primarily because of the availability of data and the relative likelihood that they have not been skewed, we have collected statistics on "Scheduled Passenger Boardings Per Employee," "Scheduled Revenue Per Kilometer Per Employee," and "Revenue Tonne Kilometers Per Employee."

15 While a low breakeven load factor appears to be inconsistent with the low employee productivity figures presented later in this report, it is apparently accomplished by paying lower than industry average wages and benefits.

Caution must be exercised when using this data. For example, a large cargo operation relative to passenger service might result in a lower passenger boarded figure. Some airlines have extensive ground handling operations and do considerable amounts of contract maintenance. Employees engaged in these operations may be counted as airline employees and thus influence the comparisons. However, these measures can still be used with some degree of certainty that the variations in operations will, to some extent, wash out.

These measures test different points. For example if an airline has a short-haul, high frequency system, the number of passengers boarded per employee should be relatively high. If an airline has a long-haul system, the boardings per employee would be lower but scheduled revenue passenger kilometers and revenue tonne kilometers produced by each employee should be high.

ALIA's comparative performance on this measure is not good. However, ALIA's low frequency operations and the far-flung route network makes a low comparative efficiency based on utilization of employees not surprising. Again, this suggests that over the long run, unless ALIA is successful in its growth plans, it will be vulnerable to the competition of more efficient and better funded operators.[16]

16 Swissair's location on this list is enlightening, in view of the carrier's reputation for "efficiency." Swissair is, in fact, a high cost operator at least partially because it compensates its employees extremely well and employs a relatively large number in its airline, airport and maintenance operations. It is instructive that Swissair is presently undergoing a layoff program for the first time in many years.

1985 EMPLOYEE PRODUCTIVITY[17]

Airline	# Emp.	Sched. Pass. Boardings/Emp.	Sched. RPK /Emp.	Rev. Tonne Km./Emp.
Eastern	39,597	1,055	1,345	139,942
American	42,162	977	1,685	164,212
Gulf Air	3,805	754	1,309	157,476
TWA	28,6[illegible]5	735	1,821	195,291
Japan Air Lines	20,565	712	1,814	298,051
Alitalia	20,417	624	827	114,842
Finnair	5,470	562	535	98,736
Pan Am	24,537	531	1,780	205,614
British Airways	37,955	446	1,083	134,666
Saudia	25,546	423	605	75,816
El Al	3,763	374	1,729	339,816
Air France	35,431	352	807	143,336
Swissair	17,683	350	713	108,698
BCAL	7,533	319	946	138,574
ALIA	**4,504**	**286**	**789**	**106,222**
Egyptair	11,599	238	382	48,629
Kuwait Airways	6,240	232	609	83,947
Pakistan Int'l	19,436	198	361	49,404
Syrian Arab	3,335	143	282	104,620

Off-setting employee productivity is the cost per employee. While airline jobs are generally highly compensated in most countries, there are differences in wage scales from country to country. In reporting data, most international airlines are less than clear in showing total wages and benefits. For U.S. airlines this is not a problem because of the DOT reporting requirements. The team has developed gross estimates of ALIA's wages as compared to a few selected international airlines. In general it would appear that ALIA's wages are lower than other major airlines. These lower wages should offset the lower employee productivity. The question is whether or not wages in Jordan will stay relatively low over time.

17 Ranked by Scheduled Passenger Boardings Per Employee.

Estimated Average Annual Wages and Benefits Selected Airlines[18]

Airline	Total Compensation ($ Converted 2/10/87)
Swissair	53,700
Japan Air Lines	49,200
Eastern	44,500
Northwest	42,500
Pan Am	42,300
American	40,600
Singapore Airlines	25,800
ALIA	**15,113**

In sum, it appears that ALIA maintains a high staffing pattern. While this might suggest some over-manning, it is highly likely that it is also a necessity, given ALIA's far-flung, low-frequency operations. In addition, ALIA's staff are relatively low paid, which provides some cushion against over-manning.

However, it is likely that greater attention will need to be paid in the future to staffing levels because competitors are considerably more efficient and Jordanian wages can be expected to rise over time. In addition, there is no question that privatization of the company will put greater emphasis on incentives not only to make a profit, but to maximize profits.

It should not be surprising that pressure on staffing levels will occur. U.S. carriers have undergone substantial changes in this area as a result of deregulation, which pitted them against each other without government regulation of routes, fares or rates of return. British Airways took several years to pare down its staff prior to putting its stock on foreign exchanges. ALIA cannot expect to escape this trend, even _without_ privatization.

However, it _is_ reasonable to expect ALIA to be able to move toward increasingly efficient operations without having to implement a major reduction in staff. This is because the carrier can be expected to grow rapidly enough to afford its

18 Estimates were derived, for the most part, from figures in 1985 annual reports. Airline executives were also queried about the derived figures to determine whether or not they would seem to be approximately correct, particularly in relative terms. Conversion rates were used as of 2/10/87. This date of conversion will skew the figures somewhat.

current staffing level. Control of staffing increases in the future will be the key to increased efficiency and profitability.

7. Fleet Plan

One of the most important single decisions an airline makes is on its fleet plan. ALIA has an extremely difficult fleet planning task because its diverse route structure makes the effort to achieve a simple fleet very difficult. The fleet plan developed by ALIA's management makes sense for its operation.

In the fall of 1986, ALIA's fleet consisted of:

Boeing 707-320C	3
Boeing 727-200A	4
Boeing 747-200B	2
Lockheed 1011-500	8
Total	17

Two Airbus A-310's are scheduled for delivery in 1987. Additional A-310's are planned in later years. These aircraft, which seat about 210 - 220 passengers are well suited to the medium haul and higher density European and regional routes.

ALIA has also ordered six A-320's. These aircraft will seat 150 passengers and will serve the lower density routes. The A-320 has the lowest fuel burn and lowest seat mile cost of any aircraft in its class.Delivery will begin in 1990. They will replace the 727's.

ALIA intends to keep the L-1011's for the present. It is an expensive aircraft to operate but it has range and it has three engines. This avoids ALIA having to experiment with two engine over water technology at this time.

The long range 747's will be retained. In ALIA's view, this aircraft is the best and most flexible airplane for long range routes if there is sufficient traffic.

The Boeing 707's are used for freight. They cannot be considered efficient. On the other hand, 747-200F freighter aircraft are too expensive and too large for the routes on which ALIA operates its 707's. That leaves little choice but to continue with a 707 or comparable.

In summary, it appears that ALIA has chosen aircraft that are appropriate for its routes[19]. The fleet is fully competitive with the aircraft used by ALIA's principle international competitors.

8. Yield Management

Airlines generally run on very thin operating margins. In the U.S., most airlines try to achieve a 5% operating margin. Because of these thin margins, small changes in yield are critical to profitability.

In the United States, most airlines have developed computer based yield management systems. This is necessary to balance the seats allocated to the various types of discount traffic. The objective is usually to maximize the revenue per aircraft mile.

ALIA's yield management system was discussed briefly with ALIA management. There was not sufficient time to determine whether the systems ALIA is using are sufficiently sophisticated to meet its needs for the long term. Because ALIA is a relatively small company, it is not necessary that it use the type of sophisticated systems used in the U.S. In any follow up project, this should be discussed in more detail.

9. Cargo

ALIA's growth in the cargo markets began with the addition of 707's to the fleet in 1971. Cargo increased from 630 tonnes in 1964 to 40,620 tonnes in 1985. This is an annual growth rate of 21.9%. In 1985, cargo and excess baggage revenue amounted to JD 18,292. This was down somewhat from the peak year of 1982. ALIA forecasted substantial improvements in 1986. The actual results are not yet known.

Of particular importance is the percentage of total revenue derived from cargo and excess baggage. Given the excellent cargo potential of the ALIA fleet, it would be hoped that the cargo revenue as a percentage of passenger revenue could be relatively high. In 1985, ALIA derived 13.9% of its revenue from cargo, excess baggage and mail. ALIA had achieved 19% in 1981. By comparison with other airlines, the table shows ALIA is doing well.

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[19] ALIA selected Airbus equipment over competitive Boeing equipment. ALIA indicated that this decision was based in part on final price and the financing package. In addition, it should be noted that the Airbus products selected have somewhat better freight potential than the competitive Boeing products.

Airline	Percentage Revenue Cargo/Mail
Singapore Airlines	26.2
JAL	22.0
Swissair	15.8
Northwest	15.4
ALIA	**13.9**
Pan American	8.3

A high percentage of cargo revenue generally reflects better use of equipment and better management of yield.

The trend of cargo revenue by region shows that the North Atlantic market has fallen off. This reflects market trends. Other airlines also experienced similar declines in these markets.

Cargo yields by region reflect the competitiveness of the market place as the table shows.

Cargo Net Yield by Region
(Rev. per RTK-CGO)

Region	Yield in Fils-1985
North Africa	186
Middle East	153
Europe	147
Gulf	126
North America	87
Far East	74
System	102

The North Atlantic and Far East cargo markets are known for cut throat pricing and low yield and ALIA's experience is probably typical of comparable airlines. The impact of these competitive markets on ALIA's yields and cargo revenues are reflected in the pulling down of system yield.

V. ISSUES RELATED TO PRIVATIZATION

A. Government Subsidy

One of the most troublesome issues related to privatization of international airlines is the possibility of having to compete against foreign national airlines that are either directly or indirectly subsidized by their governments. To the extent such subsidization occurs, an airline may provide better service in terms of frequencies than it would as a private operator, possibly at lower prices.

While subsidization has been common in the past, most countries are becoming less and less anxious to devote funds for this purpose in the face of other competing demands for public monies. Since the airline industry is no longer a fledgling industry, it is increasingly hard to justify its support, except for minimal defense and public service purposes. Also, the argument that airline service should be considered a public utility is waning in conviction. Certainly, lavish support for reasons of prestige is no longer tolerated in most countries.

Thus, while many countries are still supporting their airlines through indirect means and some countries can still justify supporting uneconomic operations (typically in under-developed parts of the world), it is increasingly less likely that a private airline will have to compete against a grossly subsidized competitor. From an investment standpoint, low cost competitors are of much greater concern than high cost operators that receive direct government subsidy.

To the extent that indirect government support is a factor in ALIA's competitive environment, it appears that ALIA is itself a beneficiary and will continue to be one. The Jordanian government has provided the airline with direct support in times of war and, presumably, would do so again, particularly in view of the airlines's record of returning to profitability on its own. ALIA also benefits from government guarantees of its debt service. Finally, ALIA management has reason to believe that it would enjoy a tax-deferred status for a period of nine years after privatization.

B. Preparation of Corporation for Private Ownership

Many of the steps which should be made prior to becoming a private company have already been taken by ALIA. The company has refurbished its public image, has respectable accounting practices, has been cleaning up its balance sheet, and has been making a effort to weed out excess overhead.

ALIA may also want to consider the appointment of a private Board of Directors. As indicated in the initial study:

> "Much would be gained by naming a new board of directors consisting of private sector businessmen...and allowing the management and board to begin to act independently in accordance with a publicly stated profit mandate and articulated goals generally corresponding to the kind of objectives listed above."[20]

The government would retain a seat on the Board of Directors, reflecting its stock ownership interest.

C. Placement of Stock

At the present time, private placement of stock is being contemplated, as opposed to selling the stock on a public stock exchange. Issuance on a public exchange is being contemplated as a possible second phase. This approach makes eminent sense for the following reasons.

First, and of greatest importance, the potential for political disruption in the Middle East simply imposes too great a risk for most "international investors" to purchase the stock. ALIA's experience during the war in 1967 and subsequent disruption would support this concern, even though the company has been able to build back to profitability.

Second, in view of the size of ALIA, its stage of development and expansion, and its relatively high cost structure, the carrier would not be appealing to a broad base of foreign investors. This may not be true at some point in the future after ALIA's development strategy is more mature.

Third, ALIA can proceed to put a portion of newly issued stock in the hands of its employees prior to providing for wider distribution of the stock. This is not an unimportant point insofar as it is one of the company's avowed reasons for wanting to privatize in the first place. The objective would be to provide employees with performance incentives and with the means of participating in their company's growth potential.

There is a likelihood that stock will have to be offered to employees at less than fair value. In addition, the company would want to provide its employees with some protection in the event of civil disruption in neighboring countries that adversely affects ALIA.

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20 Op. Cit. p. 12.

One way of providing protection would be to allow the employee to acquire stock that could be converted to a debt instrument at a previously determined value under specified circumstances. In effect, this is the reverse of the normal convertible debenture. The exact vehicle for accomplishing this objective needs further development by experts in the field of employee compensation.

A suggestion that has been made[21] that a potential and logical purchaser of ALIA stock would be the Jordanian Pension Fund. In addition, it is expected that Jordanian expatriates can be tapped for additional investment. Again, it may be necessary to employ the services of a financial advisor to explore all possible sources of new capital at this stage. It will certainly be necessary to do so at the time the stock is distributed on foreign exchanges.

D. "Substantial Ownership and Control"

Most countries, if not all, have an interest in having the majority of stock in a national airline retained in the hands of the country's nationals. In addition to concerns about the use of aircraft during times of war, this interest is inspired by the remnants of the belief that an air carrier is, in some way, a public utility and is thereby responsible to the public. Assuming that a private operator is not motivated by the public interest, a government certainly wishes to retain some control over its activities so that its actions can be directed if the need to do so arises. This would be hard to do if a government had to "reach" to foreign ownership to enforce its edicts or regulations. Finally, most air transport agreements between countries specify that carriers authorized to operate under the terms of the agreements must be able to demonstrate that their "ownership and control" is in the hands of nationals. (The purpose of this requirement is obviously to keep one country from negotiating rights with a second country for operations by a carrier from a third, possibly unknown, party).

One way to retain ownership and control in the hands of the nationals of a country is to issue a "golden share" of stock which is retained by the government. This approach has recently been used by the U.K. government during the privatization of British Airways. Essentially, the golden share carries with it the power to intervene in defined circumstances.

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21 Survey of Initial Prospects for Privatization in the Hashemite Kingdom of Jordan, Op. Cit., p. 13.

VI. CONCLUSIONS - RECOMMENDED PROGRAM

The conclusion of initial survey conducted by the Center for Privatization is affirmed by this technical study, namely, that ALIA should proceed toward privatization. The airline is small by international standards and its competition is vigorous. These are not justifications, however, for keeping ALIA as a public body. Quite the contrary, they suggest the company should be privatized as quickly as possible in order to permit it to respond to the forces of its competitive markets.

In addition to proceeding with the refinancing and market planning that is currently underway, ALIA may want to retain the services of an investment banker to test the assumption contained in this report that sale of stock on foreign exchanges is not now appropriate. Even if this is the case, ALIA should be shaping its management and operating practices with this objective in mind.

In addition, ALIA will want an expert in employee stock ownership matters to design a security for its employees, taking into consideration the special factors mentioned in this report.

- THE END -

This report was prepared for the Center for Privatization by Judith T. Connor and William A. Kutzke.

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