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Author(s)	Henderson, Joan C.
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**CATHAY PACIFIC :
FLYING THROUGH TURBULENT TIMES**

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Joan C. Henderson

After recovering from the Asian financial crisis at the end of the 1990s, Cathay Pacific was to confront a number of difficulties in 2001. Amid growing competition amongst airline carriers worldwide, a long-standing industrial dispute between the company and its pilots surfaced again in the middle of the year and resulted in flight delays and cancellations. Terrorist attacks in the USA on September 11 then had dramatic consequences for global air travel, leading to falls in demand and revenue. The case outlines these events and their consequences for Cathay Pacific's management and describes its responses, providing an insight into some of the challenges of airline operation in a period of uncertainty and its vulnerability to internal and external pressures.

Associate Professor Joan C. Henderson prepared this case with research assistance from Research Associate Chung Sang Pok. The case is based on secondary sources especially media reporting of events and press releases. As the case is not intended to illustrate either effective or ineffective practices or policies, the information presented reflects the author's interpretation of events and serves merely to provide opportunities for class discussion.

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For copies, please write to The Asian Business Case Centre, Nanyang Business School, Nanyang Technological University, Nanyang Avenue, Singapore 639798
Phone: +65-6790-4864/6790-5706, Fax: +65-6791-6207, E-mail: asiacasecentre@ntu.edu.sg

ASIAN AIRLINES

The civil aviation business had been historically dominated by North America and Europe, but Asia Pacific was a significant generator of air traffic with higher growth rates than the more mature markets by the 1990s. This was partly the result of Asia's economic boom during the 1980s which stimulated international air travel and led to rapid fleet expansion. However, heavy costs, increased competition and the Asian financial crisis of 1997 adversely affected the region's airline industry which experienced a decline in passengers and profits. Recovery appeared underway at the end of the decade with growth seen again in 1999, but there was still uncertainty ahead as a result of intensifying competition and rising costs as well as moves towards deregulation in what was traditionally a tightly regulated and protected sector. Details of some of the principal Asia Pacific airlines at the close of the 20th century are contained in **Exhibit 1** and all faced opportunities and problems in the unpredictable world of the 21st century.

CATHAY PACIFIC

Founded in 1946 in Hong Kong, Cathay Pacific Airways Limited grew with the British colony which became a Special Administrative Region (SAR) of China in 1997. Cathay Pacific was one of the most successful airlines in Asia and enjoyed a favourable reputation for its service and safety standards. It maintained double-digit growth in revenue until the early 1990s when circumstances started to change against the background of an increasingly competitive aviation industry, encouraging the airline to seek greater efficiency and productivity. Profits were further damaged by the Asian financial crisis with losses of HK\$542 million in 1998, the first since Cathay Pacific's establishment. These were restored by 2000 when the company had a turnover of HK\$34.5 billion and carried 11.9 million passengers, achieving an average load factor of 76.2. More financial information about Cathay Pacific for the years 2000 and 2001 can be found in **Exhibits 2 and 3**.

The airline operated about one quarter of all flights out of Hong Kong's Chek Lap Kok airport and transported a significant number of tourists to Hong Kong, approximately one third in 1998. The majority

of Asia Pacific air travel was intra-regional and the busiest international route was that between Hong Kong and Taipei, the former airport handling most regional international arrivals with 27.9 million in 1998. Cathay Pacific was part of the Swire Group and listed on the Stock Exchange of Hong Kong, the major shareholders being Swire Pacific Limited which owned 45.9 percent and the Chinese conglomerate CITIC (China International Trust and Investment Corporation). It joined the Oneworld international airline alliance in 1998 which linked it to carriers such as American Airlines, British Airways and Qantas through code sharing and other cooperative arrangements.

CATHAY PACIFIC PILOTS

The company employed more than 14,700 people in 30 countries and territories around the world in 2001, labour constituting approximately 25 percent of total costs. Over 10,600 of these worked in Hong Kong, about 1500 of whom were pilots. Cathay Pacific offered generous salaries and allowances and recruited pilots from nations such as Australia, New Zealand, Canada and the UK. Local pilots, on a lower rate of pay which excluded expatriate benefits, numbered only about 139. A spokesman had said in 1999 that while cockpit crew comprised 10 percent of the workforce, they accounted for nearly 40 percent of all staff costs.¹ Newspapers reported that the pilots were amongst the highest paid in the world, senior officers earning HK\$3.4 million annually inclusive of allowances.² The union, the Hong Kong Aircrew Officers' Association (HKAOA), represented 1,300 members or 85 percent of the airline's pilots in June 2001.

The more challenging market conditions in the 1990s prompted management to pursue cost savings and labour was one target. Different pay scales and terms of employment had been introduced for pilots in 1993 whereby those hired after March of that year were awarded lower salaries and fewer benefits. The corporate losses of 1998 made the need for savings more urgent and prolonged talks with the union over salary reductions for pilots who joined prior to 1993 were held, but failed to reach agreement and the relationship between the two parties deteriorated. The company approached pilots directly in 1999 and pay was reduced by between 10 percent and 20 percent,

1 No sympathy for Cathay's pilots. (1999, June 3). *The Straits Times (Singapore)*.

2 Pilots' call for hefty pay rises earns criticism. (2001, July 7). *The Straits Times (Singapore)*.

depending upon where they were based. The union responded with a 'sick-out' during which pilots called in sick en masse and there was a two-week period in mid-1999 when about 1,000 flights were cancelled, leading to estimated losses of HK\$500 million for the company. A three-year deal was then agreed with the union covering pay cuts for pre-1993 staff, pay rises for others, provident fund guarantees and contractual provisions on certain benefits which had hitherto been discretionary. Management also wanted to reform the rostering system, the mechanism for allocating flight duties, and this was another issue of contention with the union.

Negotiations with the union on rostering were still underway in 2001, yet there had been little progress in over 50 meetings. The airline's financial situation recovered and record profits for 2000 were revealed in March 2001. The Chairman attributed the results to the "strength of our regional economies and the company's success in improving productivity over the past five years. If we had not reduced our cost base over this period, we would have struggled to break even in 2000".³ In recognition of the more favourable circumstances, management proposed that the pay cut for the pilots who joined before 1993 be returned to them by way of an hourly duty allowance with salary increases for others. The offer was described as "pay rises of up to 10.5 percent, provident fund increases of 15.5 percent, additional overtime pay with premiums of up to two and half times their basic hourly pay and significant improvements in roster practices".⁴ These terms failed to meet the union demands and, at the same media briefing, the Corporate Development Director (CDD) stated that "we cannot give the union everything it wants. We have to remain competitive for the good of our staff, customers and Hong Kong".

The company's discussions with the union about the proposals collapsed in considerable acrimony and it set midnight of 30 June as the date for acceptance by the pilots. A Press Release on 28 June advised that "given the threat of imminent industrial action, Cathay Pacific is working hard on a range of contingency plans to protect passengers. The airline

is prepared to charter aircraft and book passengers on other airlines". It apologised to passengers for the inconvenience and said that bookings would continue to be made as normal. There was no positive reply from the union by the deadline and subsequent developments for that year are summarised below.

EVENTS AND ACTIONS FROM JULY TO DECEMBER 2001

July

A new "go-slow" campaign started on 3 July, the HKAOA having introduced contract compliance or work to rule some years previously. Pilots rigidly adhered to operating rules and regulations and took as long as possible to perform various tasks. This meant serious delays to flights at the time of summer vacations, one of the busiest periods in the year. There were 100 cancellations by the fourth day and Typhoon Utor sweeping across Southern China added to the disruption. Management sacked three pilots for infringement of duty and the HKAOA pledged to maintain industrial action, with sick calls doubling in number. Soon, Hong Kong was experiencing the "largest flight cancellation" in its aviation history, involving 5,400 passengers.⁵

Cathay Pacific issued regular press releases and held media briefings to provide information about what was happening and the implications for services. Passengers were assured that the situation was being monitored and they would be kept fully updated. Enquiry telephone hotlines in English and Chinese were set up and news was made available online. There were constant messages apologising for the inconvenience and management committed itself to "do all we can to keep our passengers and cargo moving",⁶ the CDD promising a "reliable, albeit reduced, schedule".⁷ Planes and crews were chartered from six Chinese mainland carriers, as well as Singapore Airlines, Malaysia Airlines and China Airlines of Taiwan. A total of 17 aircraft were hired and were flying about one third of the timetable in early July. Senior cabin crew "ambassadors" from

3 Cathay Pacific press release. (2001, March 7). *Cathay Pacific posts record annual profit for 2000*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/intl/aboutus/press/0,3845,31342-40586,00.html>

4 Cathay Pacific press release. (2001, July 1). *Cathay Pacific regrets AOA rejection of enhanced pay proposal*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/intl/aboutus/press/0,3845,31342-71052,00.html>

5 *The Straits Times (Singapore)*, 9 July 2001.

6 Cathay Pacific press release. (2001, July 1). *Cathay Pacific regrets AOA rejection of enhanced pay proposal*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/intl/aboutus/press/0,3845,31342-71052,00.html>

7 *The Straits Times (Singapore)*, 9 July 2001.

Cathay Pacific accompanied the flights, but there was speculation in the press about a "dumbing down of the product" because "differing service standards may disappoint Cathay passengers expecting the premium service they paid for in buying Cathay tickets".⁸ Other airlines flying on the Hong Kong route either added flights or deployed larger planes to ease the build-up of stranded passengers at Hong Kong airport.

Services were suspended on 12 routes determined by criteria defined by management as "passenger booking levels, availability of alternative carriers and conservation of pilot resources".⁹ Approximately 20 percent of scheduled flights were temporarily withdrawn and passenger numbers were to fall by 30 percent in July over the same month in 2000. Travel agents were advised that the airline would temporarily stop taking bookings for some long-haul flights. The reconfiguration of three planes to accommodate more business class seats on a new non-stop flight to New York was postponed due to uncertainty about when the service would be introduced. Aircraft also had to be re-routed and arrangements made for passengers from cancelled or severely delayed flights.

Cathay Pacific announced that after a review of staff employment histories, it had sacked 49 pilots (23 captains and 26 first officers) who could not be "relied upon to act in the best interests of the company in the future".¹⁰ Company managers at a press conference said that Hong Kong was "tired of being held to ransom" and they could not "allow this group to disrupt the airline, its employees, our customers or the reputation of Hong Kong".¹¹ Forty of those dismissed were members of the HKAOA which expressed outrage at the way the pilots had been treated and heightened union action seemed likely.

Company share prices were falling, according to the press, which mentioned figures of between HK\$350 and HK\$500 million, losses from key routes estimated to be HK\$9 million daily. The monthly cost of leasing planes was calculated at HK\$200

million and there had been additional expenditure in areas such as the provision of accommodation for affected passengers.

The media also reported on the concerns voiced by Hong Kong politicians and representatives of the tourism industry about the impact of the disruption on the company, tourist arrivals and the image of Hong Kong. The SAR's Economic Services Secretary argued that the economy "should in no way be hijacked by the actions of a few hundred people or a number of people who have repeatedly in the last few years been threatening actions of one kind or another". There were newspaper articles suggesting that Cathay Pacific's pilots' long-term loyalty to Hong Kong was questionable because of their expatriate status. An editorial in the Chinese language *Ming Pao Daily News* observed that "the difficulty here is that more than 90 percent of the flight crew are employed from overseas, and expecting them to be accountable to Hong Kong's wider interests may be asking for the impossible". Readers were reminded about the comparatively large salaries of the pilots and the writer urged them to recognise their responsibilities to the public and end the dispute. The Chairman of the Hong Kong Tourism Board suggested that travellers fly with other airlines and the Chief Executive of the SAR, a frequent Cathay Pacific passenger, chose to travel with another airline.¹²

Although cancellations were still occurring in the middle of the month, their number and the extent of delays had lessened. On the 14 July, for example, 130 out of 136 scheduled flights departed and plans were made public to restore suspended services. Five of these were expected to resume the following week and the New York service by 1 August, leaving only two to Karachi and Manchester not flying. Charters from other airlines ceased and the CDD said that "things are returning to normal pretty rapidly".¹³ In answer to a press question about the replacement of dismissed pilots, the company replied that the recruitment process would function as before, from both Hong Kong for the cadet scheme and overseas for the balance of the required

8 Cathay pilots union says resolve is growing --- membership has climbed since firings. (2001, July 13). *The Asian Wall Street Journal*, p. 4.

9 Greater China: Cathay cuts flights, enlists planes --- schedule shrinks 20% in reaction to surge of sick calls from crews --- 'the pilots are not going to help them out' in wake of storm. (2001, July 9). *The Asian Wall Street Journal*, p. 3.

10 Cathay steps up union battle, firing 49 pilots --- airline to impose package of pay and benefits increases. (2001, July 10). *The Asian Wall Street Journal*, p. 1.

11 Cathay Pacific acts, sacking 49 pilots. (2001, July 10). *The Straits Times (Singapore)*.

12 Tung plays safe, switches from Cathay to United. (2001, July 10). *The Straits Times (Singapore)*.

13 Cathay pilots to sustain slowdown campaign --- airline says few flights are being cancelled. (2001, July 19). *The Asian Wall Street Journal*, p. 3.

crew. There had been no decision to speed up local recruitment which was already progressing as fast as it could.

Management went ahead in implementing its own new pay and benefits package at a cost of HK\$200 million. This incorporated wage increases of 9 percent, a revised overtime scale and roster changes. The intention was to link pay more closely to hours worked, rather than to a flat annual salary, and stabilise rostering. Pilots hired before 1993 were to effectively receive a 4 percent rise in pay while those employed later would get 6 percent. Overtime would be paid monthly after 84 "credit" hours per month at 1.5 times standard pay, with further increases to 2.5 after 92 hours and a top rate of 3.5. The arrangements aimed to achieve greater efficiency and a more evenly distributed and equitable workload amongst pilots over the year. Pilots were pressed to cooperate and "acknowledge the competitive realities for this airline and the global commercial aviation industry in which Cathay Pacific operates".¹⁴ Details of the proposals were distributed to pilots and 1,400 had accepted by the end of the month. However, the union contended that a total of 800 had turned the offer down and members voted overwhelmingly to persist with the "go-slow".

August

The last chartered Chinese planes were handed back at the beginning of August. The press release describing the return of the first the previous month had stated that "the mainland crews have made many new friends among their fellow flyers in Hong Kong, and the Cathay Pacific ambassadors who flew with them were certainly impressed with their professionalism, commitment and eagerness to learn all about Cathay Pacific". The occasion was marked by the presentation of flowers and picture frames for "photographic memories of their time in Hong Kong".¹⁵

Management announced in early August that 1,561 pilots would be moving to the new scheme while 47 had chosen to stay on the old. These figures were again contradicted by the union and 94 percent of

members elected to continue industrial action and 92 percent to extend it at the end of the month. Roster uncertainty was created by a sharp rise in pilots reporting sick and the company cancelled some flights. For example, six services were withdrawn on both 19 and 20 August, two pairs of flights on 21 August and one pair on 22 August. Passenger numbers for the whole of August were down 5.2 percent on the previous year.

The company reported a 39 percent drop in net profits for the first half of the year, with a smaller dividend, and warned of difficulties ahead due to the industrial dispute and adverse economic conditions. A reporter wrote that "unlike previous disputes, this one feels like a fight to the finish. For the management, this latest brawl is a fight for survival: an opportunity to bust the pilots' union and boost the airline's competitiveness amongst its Asian rivals"¹⁶ and other journalists interpreted events as an illustration of Cathay Pacific asserting its power over the union.¹⁷

September

There appeared to be growing stability by September with few delays or flight cancellations. However, management still had to deal with a series of disruptive sick calls and union hints of further limited industrial action into 2002 and possibly until the 2008 Olympic Games in Beijing. The attacks of September 11 in New York and Washington then had an immediate effect on air travel around the world as demand fell and additional spending was necessary on security measures and insurance premiums, damaging revenue and profit margins.

Passenger numbers dropped by 12 percent in September 2001 against 2000 and the company curtailed its weekly schedule by between 3 percent and 4 percent on two occasions. Recruitment, which had been taking place prior to September 11 with a total of 20 pilots hired, halted despite a pool of unemployed flight crew due to the global air industry slump. The company expressed its desire to manage the crisis without recourse to redundancies, but a letter to staff on September 28 noted that there was

14 Cathay Pacific press release. (2001, July 19). *Statement on pay, benefits and overtime package*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/int/aboutus/press/0,3845,31342-71148,00.html>

15 Cathay Pacific press release. (2001, July 14). *Cathay Pacific bids farewell to first charter aircraft*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/int/aboutus/press/0,3845,31342-71079,00.html>

16 Granitsas, A., & Westlake, M. (2001, Aug 23). Cathay goes for broke. *Far Eastern Economic Review*, 40-43.

17 *The Asian Wall Street Journal*, 22 August 2001.

"little choice but to demonstrate far less tolerance" towards any pilot taking part in industrial action and the focus was now on "keeping the airline afloat".¹⁸

October-December

In early October, the impact of the union campaign seemed to be diminishing with 84 percent of flights departing on time compared to 70 percent in July. Nevertheless, passenger traffic was down by 16.6 percent over October 2000 largely as a consequence of September 11 and its aftermath. The company reviewed its network and temporary cuts were introduced on 19 October. These covered fourteen weekly flights or 3 percent of the schedule in addition to the 4 percent withdrawn in the previous week. A Press Release assured the public that the company was still "offering passengers a comprehensive network" and flying daily to the destinations affected.¹⁹

Management also had to contend with various legal challenges being mounted at home and overseas by pilots seeking redress for unfair dismissal. It expressed its impatience, saying there was a possibility of closing foreign operations and recalling pilots to Hong Kong if labour law problems were encountered overseas.²⁰ On the question of retrenchment, the CDD commented that "Cathay

Pacific has no plans at the moment to reduce staff numbers. This airline is not immune to the pressures on the industry, but any staff reductions would only be implemented as a very last resort".²¹ Calls for an end to the slowdown and union insistence on the reinstatement of dismissed pilots were repeated. Pilots were told that they should have "realistic expectations given the very difficult operating environment".²² The airline undertook disciplinary action against those pilots identified as deliberately causing flight delays. Three pilots were demoted and all were asked to stop wearing yellow ribbons, a symbol of solidarity with sacked colleagues, when on duty or on company property.

Contract compliance was suspended by union leaders from October 21 and negotiations between the company and union began on October 22. There was another meeting on October 30, but talks came to an abrupt halt and there was disagreement about discussions which had been held secretly in September, management saying a compromise put forward then had been rejected. The union denied any such offer had been made and was due to meet on December 19 to discuss a return to industrial action. Meanwhile, passengers carried in November and December declined by 13.8 percent and 2.4 percent respectively, compared to the same period in 2000.

18 HK Cathay losing patience with pilots' industrial action. (2001, October 4). *Dow Jones International News*.

19 Cathay Pacific press release. (2001, October 19). *Cathay Pacific announces temporary flight reductions*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/intl/aboutus/press/0,3845,31342-71906,00.html>

20 HK Cathay losing patience with pilots' industrial action. (2001, October 4). *Dow Jones International News*.

21 Cathay Pacific press release. (2001, October 11). *Cathay Pacific to temporarily suspend a number of flights*. Retrieved October 15, 2002, from <http://www.cathaypacific.com/intl/aboutus/press/0,3845,31342-71900,00.html>

22 Cathay Pacific pilots suspend industrial action. (2001, October 20). *Agence France-Presse*.

EXHIBIT 1

**TRAFFIC ON INTERNATIONAL ROUTES OF ASIAN MEMBERS OF AAPA
(ASSOCIATION OF ASIA PACIFIC AIRLINES), 1999**

AIRLINE	SEATS SOLD (000)	ASK (MILLION)	RPK (MILLION)	LOAD FACTOR (%)
All Nippon Airways	3505	31044	20516	66.1
Asiana	2673	13720	9341	68.1
Cathay Pacific	10299	60295	40679	67.5
China Airlines	6475	29026	20153	69.4
Eva Airways	3637	23846	16662	69.9
Garuda	2131	23125	16486	71.3
Japan Airlines	11366	88772	62369	70.3
Japan Asia Airways	1449	4572	2929	64.1
Korean Air	6818	41856	28140	67.2
Malaysia Airlines	6249	40140	27098	67.5
Philippine Airlines	1306	9163	5920	64.6
Royal Brunei Airlines	846	5457	2896	53.1
Silkair	736	1459	933	64
Singapore Airlines	12777	83192	60300	72.5
Thai Airways	8833	43647	29720	68.1
Vietnam Airlines	902	3524	2502	71.0

ASK: Airline seat kilometres (total number of seats offered multiplied by distance flown)

RPK: Revenue passenger kilometres (number of paying passengers on a flight multiplied by number of kilometres flown)

Load Factor: Percentage of seats actually utilised by revenue-paying passengers

Source: Travel & Tourism Analyst, 2000.

EXHIBIT 2

CATHAY PACIFIC'S FINANCIAL AND OPERATING HIGHLIGHTS, 2000-2001

Group Financial Statistics	2001	2000	% Change
Results			
Turnover (HK\$m)	30,436	34,523	-11.8
Profit attributable to shareholders (HK\$m)	657	5,005	-86.9
Earnings per share (HK cents)	19.7	148.4	-86.7
Dividend per share (HK cents)	17.5	65.0	-73.1
Profit margin	2.2	14.5	-12.3pt
Balance Sheet			
Shareholders' funds (HK\$m)	31,308	32,832	-4.6
Net borrowings (HK\$m)	14,278	9,886	+44.4
Shareholders' funds per share (HK\$)	9.4	9.8	-4.1
Net debt/equity ratio	0.46	0.30	+0.16 times
Operating Statistics - Cathay Pacific			
Available tonne kilometres (AKT) (m)	11,827	11,630	+1.7
Passenger load factor (%)	71.3	76.2	-4.9pt
Passenger yield (HK cents)	45.7	48.2	-5.2
Cargo and mail load factor (%)	67.3	72.5	-5.2pt
Cargo and mail yield (HK\$)	1.85	2.07	-10.6
Cost per ATK (HK\$)	2.36	2.32	+1.7
Cost per ATK without fuel (HK\$)	1.93	1.86	+3.8
Aircraft utilisation (hours per day)	12.1	12.9	-6.2
On-time performance (%)	82.9	84.0	-1.1pt

Source: Cathay Pacific Airways Limited Annual Report, 2001

EXHIBIT 3
CATHAY PACIFIC'S OPERATING EXPENSES, 2000-2001

	2001 HK\$m	2000 HK\$m	CHANGE %
Staff	6,857	6,742	+1.7
In-flight service and passenger expenses	1,586	1,677	-5.4
Landing, parking and route expenses	4,815	4,724	+1.9
Fuel	4,985	5,319	-6.3
Aircraft maintenance	3,177	2,796	+13.6
Aircraft depreciation and operating leases	3,837	3,127	+22.7
Other depreciation and operating leases	728	726	+0.3
Commissions	534	711	-24.9
Exchange (gain)/loss	(105)	160	-165.6
Others	911	686	+32.8
Operating expenses	27,325	26,668	+2.5
Net finance charges	535	307	+74.3
Total operating expenses	27,860	26,975	+3.3

Source: Cathay Pacific Airways Limited Annual Report, 2001