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30 October 2006

A Summary and Analysis of the 2005/6 Annual Report of South African Airways

1. Introduction¹

South African Airways (SAA) is a state-owned enterprise and is currently Africa's leading airline. SAA's main activities are to operate international, regional and domestic scheduled air services for the carriage of passengers, freight and mail. It serves more than 700 destinations (34 cities in 26 countries on six continents) throughout the world, carrying more than 6.5 million passengers annually. SAA employs close to 12 000 people worldwide, including 3 600 at SAA Technical, a 100% subsidiary of SAA. Staff include about 2 800 flight attendants and more than 800 pilots.

SAA Technical at Johannesburg International Airport is the largest maintenance facility in Africa and spends 50% of maintenance costs on engines. It performs the maintenance of more than 40 major airlines, including British Airways, Singapore Airlines, Air France and Lufthansa.

Since the beginning of 2003, SAA has won awards for:

- Best African airline.
- Best South African domestic airline.
- Best international airline flying to South Africa.
- Best cabin crew in Africa.
- Best airline based in Africa.

SAA's vision is to be the carrier of choice in the markets they serve. The company conducts its operations based on the following values:

- Customer focus: anticipating and striving to understand customers' individual needs.
- Accountability: taking responsibility for individual and team actions, decisions and results by establishing clear plans and goals and measuring progress against these.

¹ Information obtained from the Department of Public Enterprises website and the SAA Annual report 2006.

- Integrity: practising highest standards of ethical behaviour and maintaining credibility.
- Safety: adopting a zero-defect mentality and striving for zero accidents through proper training, work practices, risk management and adherence to safety regulations.
- Excellence in performance: setting their goals beyond the best in the market, reinforcing high quality standards and achieving excellence through implementing best practices.
- Valuing our people: treating their staff with respect, dignity and fairness in order to ensure their satisfaction, development and well-being.

2. SAA performance

The following highlights were experienced during the year:

- SAA's passenger numbers rose by 4.5% despite the airline losing market share to low-cost carriers.
- It reduced sales and distribution costs and increased sales by direct channels such as the flysaa.com website and telephone call centres.
- Cost-cutting initiatives and efficiency improvements continue to decrease the airline's cost base.
- The five-year fleet renewal programme has been completed.
- Upgrading of IT platforms and reservation system to the Amadeus platform, thus boosting their service to the travel trade.
- Opened routes to Zanzibar, Tanzania and Livingstone, Zambia and increased frequency of flights to Washington and between Cape Town and Frankfurt. Unprofitable routes have been stopped, such as flights between Port Elizabeth and Cape Town, Port Elizabeth and Durban and between Johannesburg and George.

The following challenges were experienced:

- Passenger revenue increased by only 0.8%, despite the increase in passenger numbers.
- Yields fell by 3.5% and a profit of R65 million was made (R648 million in 2004/5).
- The fuel bill increased from R1.7 million to R4.9 billion.

3. Key priorities²

The chairperson, Prof Gerwel, identified the following as areas of concern and/or importance relating to SAA's business:

- Transnet unbundling: Transnet's stake in SAA will be transferred to the Department of Public Enterprises in 2006/7.

² Information obtained from the SAA Annual report 2006.

- Sustainability: SAA strives to adhere to the principles of sustainable development. This behaviour should affect its social, environmental and corporate governance obligations, benefit employees and maintain its standing as a trustworthy and caring corporate citizen.
- Labour relations: SAA was affected by industrial action for nearly a week in July 2006. This provided an opportunity to reassess the importance of its staff. Staff members were given a 5% increase in pensionable wages, medical and housing benefits and a 1% increase in non-pensionable allowances. In addition, a three-year agreement was made concerning the flexibility of working hours and increases in allowances and rest days. Lines of communication between staff and executives have also been improved.
- Customer service: SAA has drawn up a three-year customer service plan to ensure a pleasurable travel experience for customers. A proportion of employees have been retrained in terms of customer service. A decline in baggage complaints has been seen as a result of various baggage service initiatives.
- Awards: a number of awards have been received, confirming SAA's strong brand.
- Sponsorship: SAA's main domestic sponsorship has been the SAA Open, a national open golf tournament, and has signed up Ernie Els, Retief Goosen, Trevor Immelman and Tim Clark. In addition, it has recently announced its sponsorship of the ATP tour, an international tennis tournament.
- Corporate social investment: "The Wings of the Nation", a corporate social investment strategic plan, was launched. Its focus is on providing time and resources to assist community upliftment. At least R14.5 million was spent on projects related to education, particularly the development of mathematical and scientific skills, poverty alleviation, social and sports development and emergency assistance and relief work. SAA is raising awareness of the aviation industry among rural communities and participated in the annual "Take a Girl Child to Work" campaign.
- HIV/AIDS staff initiatives: more than R2 million was spent on various HIV/AIDS initiatives targeting affected and infected employees. This initiative included workshops, support groups and peer education schemes.
- Corporate governance: striving to implement the King II Code of Corporate Practices guidelines and the Public Finance Management Act (No. 1 of 1999) (PFMA).
- Black Economic Empowerment (BEE): the SAA Tender Control Board has approved supplier contracts to the value of R33 million to BEE companies. This was 50% of all contracts approved.
- Competition Commission: SAA has agreed to pay R100 million over two years to settle various complaints. It has done so without appealing the charges and is conducting awareness of competition law among its staff.

Issues to consider:

SAA has contributed to social and equity issues during 2005/6. However, these efforts to assist government in meeting its goals have not been made explicit. No indication has been made to the degree that social investment has positively affected communities or where these communities are located. The Annual Report as a whole does not address this and makes broad sweeping statements regarding important issues, such as labour relations, customer service and corporate social investment.

Questions:

- The implementation of various customer service initiatives is mentioned in the Annual Report. What type of initiatives has been implemented to date? What do these entail?
- What implications has the unbundling from Transnet had on SAA?
- What other local sponsorships have SAA made?
- It has been reported that SAA has not been complying with the PFMA, what corrective actions are being implemented in this regard?
- SAA promotes awareness of the aviation industry in rural communities, are there any mechanisms to assist members of such communities to pursue careers in the industry?

4. Human Resource Information

According to the Department of Public Enterprises website, SAA is running a programme called "Women in Aviation", which aims to develop high calibre female managers to feed SAA's executive leadership. Currently, 77% of SAA's leadership is black with a 56:44 male to female ratio. At senior management level, 44% are black with 41% of middle management and 55% non-management staff are black.

Issues to consider:

No human resources information is provided within the Annual Report. Thus apart from the statements made on the Department of Public Enterprises website (repeated on the SAA website), there is no other information regarding labour statistics in SAA. In addition, it is not clear when the data provided was last updated or what period it relates to.

Questions:

- Please provide a breakdown of the employees according to race, gender and people with disabilities.
- What is SAA's turnover rate and vacancy rate for the year ending in March 2006?
- What staff development mechanisms are in place?
- Is SAA involved in any learnership or internship programmes?

5. Financial Information

SAA received an unqualified audit opinion from Deloitte and Touche and APF Inc. however, the auditors mentioned a particular matter of emphasis regarding SAA's non-compliance with sub-section 55(2)(a) of the PFMA and section 28(1)(c) of the Public Audit Act (No. 25 of 2004) in providing performance information. Other concerns were the ability of the current procurement system to ensure that goods and services are procured fairly, equitably, transparently, competitively and cost-effectively; the prevention, identification and reporting of all fruitless and wasteful expenditure; and the completion of the shareholders' compact with Transnet Limited.

SAA made a profit of R65 million. This was due to increases in fuel costs and a decrease in passenger revenue. The unit cost per passenger available seat kilometre was R0.54, a R0.05 increase from 2003/4 and 2004/5. The main cause of this increase was energy cost increases.

6. Opportunities and Challenges

5.1 Star Alliance³

SAA has become a member of Star Alliance at the beginning of April 2006. Star Alliance is an awarded airline alliance, which provides an integrated frequent flyer programme, airport lounges for premium customers, coordinated flight schedules for almost seamless travel on a single ticket, special fares for round-the-world type travel, harmonised customer service processes among member airlines and cooperation to develop a common information technology platform. Thus, benefiting Voyager members and SAA customers.

Star Alliance consists of 17 international airlines, excluding SAA. These are:

- Air Canada
- Air New Zealand Limited
- ANA
- Asiana Airlines
- Austrian
- bmi
- LOT Polish Airlines
- Lufthansa
- Scandinavian Airlines
- Singapore Airlines
- Spanair
- Swiss
- TAP Portugal
- Thai Airways International
- United
- US Airways
- VARIG

It also has three regional member airlines, namely Adria Airways, Blue1 and Croatia Airlines.

³ Wikipedia (2006).

5.2 Lowering Costs - Bambanani programme

SAA is faced with the challenge of lowering its cost base, while maintaining quality customer service, as it continues to face competition from no-frills airlines. The Bambanani programme was implemented to address issues of cost cutting and yield enhancement. The programme achieved to cut costs by R500 million, this was R400 million short of the target. It has renegotiated several agreements to lower its annual costs. However, it still faces a major challenge regarding jet fuel prices, given volatile oil prices and a depreciating exchange rate. Further risk of increased prices exists as 59% of SAA's borrowings were at floating rates and 65% of loans are in US dollars.

5.3 Other Issues

The safety of passengers is of concern due to potential terrorist activities and the consequences of pandemics spread through, especially, international travel.

There has been an investigation regarding the distribution of SAA shares among its employee share schemes. The investigation has found large irregularities in these schemes.

7. Conclusion

The SAA Annual Report is largely focussed on its financial performance. Very little detail is provided regarding other concerns such as employment equity. Currently, no or very few targets are communicated in this document. This appears to be related to the shareholders' compact that has not been finalised. SAA has managed to maintain a profit during 2005/6, despite its challenges. However, performance on other levels cannot be assessed, as there is no benchmark to compare it to.

References

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