

What can be expected on Ukrainian air transportation market?

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- On October 25, 2007, the Antimonopoly Committee of Ukraine (AMCU) provided a permit for the CJSC AeroSvit Airline and the public company Donbasaero Airline to concert their activities within the "Agreement on Strategic Alliance". The main goal of this agreement, according to AMCU's decision, is the "provision of the appropriate level of Ukrainian air carriers' competitiveness in comparison with powerful world alliances, necessary consolidation of domestic airlines' efforts to protect Ukraine's interests on the international air transportation markets and to create the conditions for economic security of the state."

It is the first such significant deal on Ukrainian air transport market. Taking this fact into consideration, some questions regarding its possible impact appear. In general, mergers and acquisitions of airlines on the world market are a global trend. The main reason for this is the intensified competition for the air space, which is limited by slow development of physical land infrastructure. In order to increase their competitiveness, companies usually try to build up their capacities and increase efficiency. This goal can be achieved in different ways, particularly by consolidations with other market operators, e.g., KLM and Air France, Lufthansa and Swiss International Air Lines have chosen such solution.

Ukrainian air transport market has shown substantial growth during last years. It is considered as having a great potential: tourist prospects of Ukraine, growth in business travel, increase of individual welfare, and raised attractiveness of air transport prices as compared to alternative transport modes (rail mainly) are expected to cause further boost of both domestic and international traffic. This in turn explains why the competition on the market and for the market is intensifying. At the moment, the market cannot be regarded as competitive: the share of five airline leaders (AeroSvit, UIA, Donbasaero, UM-Air, Dniproavia) is about 90% of total amount of passenger transportation¹ The activity of foreign companies (Lufthansa, Aeroflot, KLM, Air France, Austrian Airlines, Delta Airlines, and British Airways) remains rather low. Their operations in Ukraine are regulated by bilateral agreements negotiated between governments, which limit the number of their flights to Ukraine as well as the number of flights operated by Ukrainian airlines flying abroad. On December 1, 2005, the EU and Ukraine signed an aviation agreement that allows European airlines to fly between any EU member state and Ukraine. Despite the fact that Single Sky formation can take up to five years, the market liberalization is to be expected. Thus, a tougher competition will result in ousting some players and consolidation of others.

The consolidation can occur in different ways: the formation of national flag carrier, merger with foreign companies, and consolidation between national players. The first variant is supported by the MTCU, but it is unlikely to occur and is not appropriate in respect to the public welfare, in particular the consumers' one. The second variant is more likely to take place in the future, when Single Sky is really implemented. However, it will be beneficial for foreign carriers rather than for Ukrainian ones, because Europe's airports are congested and national companies will not get the opportunity to operate the most profitable routes. Instead they will have to choose less profitable directions to Europe and compete with foreigners on the Ukrainian domestic market. Such prospects may push Ukrainian carriers to consolidate with either foreign companies or with national players. Currently, we can have an opportunity to observe the first example.

At the beginning of 2007, AeroSvit and Donbasaero announced the creation of "Ukrainian Aviation Group." Within its framework they united their fleets, optimized routes and schedule, achieved the possibility to cut the maintenance and operation costs per unit and to use Donetsk as transit point, etc. As the result, in the first half of 2007, transportation volume

¹ According to the MTCU

increased by 20% as compared to the first half of 2006.² Besides, both companies enlarged their market share: at the moment their market share exceeded 50%.³ And now, the AMCU allowed AeroSvit to buy 74.99% of Donbasaero, what will finally strengthen the leadership of this company in Ukraine.

Certainly, some negative impact on customers that is related to monopolization of passenger air transportation market can be expected. However, given the global trends and middle-term perspectives for Single Sky formation, they are unlikely to take place. In this case, the competition and market development are hindered not by airline companies but by insufficient infrastructure and lack of competition between airports. Therefore, in the long-run, the absence of reforms is more threatening than consolidation of the transportation market.

² According to airline AeroSvit

³ According to the MTCU