Malaysian Aviation Commission
Suruhanjaya Penerbangan Malaysia
MAVCOM

POSITION PAPER

SEQUENCING LIBERALIZATION FOR THE MALAYSIAN AVIATION SERVICES SECTOR

JULY 2019

This Position Paper discusses the Malaysian Aviation Commission's position and recommendations on the aviation services sector liberalization.

EXECUTIVE SUMMARY

The Malaysian aviation services sector has undergone significant liberalization, consistent with international trends for sector liberalization since the 1970s. While the understanding of liberalization tends to focus on the promotion and increase of foreign investment and ownership in the domestic industry players, the concept of liberalization is wider. Both the Malaysian and international experiences highlight that liberalization also extends to the negotiations for greater air traffic rights (ATRs) via air service agreements (ASAs), promoting private ownership, as well as, reducing and dismantling barriers to entry, thus, promoting competition in the sector.

Sector liberalization is an evolutionary rather than a revolutionary process, but its pace is hastened by technological changes. Both the Government of Malaysia (GoM) and industry players must appreciate that market liberalization process penalizes inefficient industry players, which may be forced to exit the market in the long term. Sector liberalization has been accompanied by deregulation but this does not mean unfettered access to and unbridled (potentially anti-competitive) behaviour in the market. Traditional economic regulations are no longer sufficient to regulate the more competitive market environment. Hence, the Malaysian Aviation Commission (MAVCOM) was established to be the economic regulator with the power to regulate competition matters for the sector.

This model is based on international **best practices on economic regulation, which emphasize independence, transparency, accountability, and professionalism.** These principles must be upheld and respected by all relevant stakeholders in the sector. The GoM, as the policymaker, and MAVCOM, as the regulator, should hold themselves to the highest standards of governance. The regulatory regime and the organizational capabilities to implement must exist and be independent from political intervention and regulatory capture. State-owned enterprises (SOEs) in the sector must be mindful that they are no longer part of the government, but rather independent from the government when undertaking commercial activities. For listed SOEs, they must also respect the rights of their non-government shareholders including minority shareholders. Additionally, policymakers, regulators, SOEs, and non-SOEs must behave professionally and not succumb or resort to political and regulatory capture to further their agendas.

Indeed, **respect for rule of law and independent institutional arrangements** is important to ensure that Malaysia will continue to reap the advantages and to Ultimately, this will benefit both consumers and industry players in and for the long term.

ABBREVIATIONS

Abbreviations	
Act 3	Civil Aviation Act 1969
Act 96	Loans Guarantee (Bodies Corporate) Act 1965
Act 588	Communications and Multimedia Act 1998
Act 712	Competition Act 2015
Act 771	Malaysian Aviation Commission Act 2015
Act 777	Companies Act 2016
ANSP	Air navigation service provider
ASA	Air Services Agreement
ASEAN	Association of Southeast Asian Nations
ASP	Air service permit
ATR	Air traffic right
BAA	British Airports Authority
CAAM	Civil Aviation Authority of Malaysia
CATA	Comprehensive Air Transport Agreement
CPTPP	Comprehensive and Progressive Agreement for the Trans-Pacific Partnership
CRS	Computer reservation system
DCA	Department of Civil Aviation, Malaysia
DOJ	Department of Justice, United States
DOT	Department of Transport, United States
ECJ	European Court of Justice
EMP or Master Plan	Economic Master Plan for the Aviation Services Sector
EPF	Employees Provident Fund
EU	European Union
F&B	Food and beverage
FoC	Flags of convenience
FTA	Free trade agreement
GIC	Government Investment Companies Division, MOF
GDS	Global distribution system
ICAO	International Civil Aviation Organization
JTM	Jabatan Telekom Malaysia
JV	Joint venture
KNB	Khazanah Nasional Berhad
LCC	Low-cost carrier
LTAT	Lembaga Tabung Angkatan Tentera
MAAS	ASEAN Multilateral Agreement on Air Services
MAB	Malaysia Airlines Berhad
MAFLPAS	ASEAN Multilateral Agreement on the Full Liberalization of Passenger Air Services
MAG	Malaysia Aviation Group
MAHB	Malaysia Airports Holdings Berhad

Abbreviations	
MAS	Malaysia Airline System
MAVCOM or the Commission	Malaysian Aviation Commission
MOF	Ministry of Finance, Malaysia
MOF Inc.	Minister of Finance, Incorporated
MOT	Ministry of Transport, Malaysia
NAI	Norwegian Airline International
NAP	National Aviation Policy
OECD	Organisation for Economic Co-operation and Development
PNB	Permodalan Nasional Berhad
PPP	Public-private partnership
PSO	Public service obligation
RAS	Rural air service
RASK	Revenue per Available Seat Kilometre
RM	Ringgit Malaysia
SOE	State-owned enterprise
STOLport	Short take-off and landing airport
TFEU	Treaty on the Functioning of the EU
TM	Telekom Malaysia
UK	United Kingdom
US	United States

AIRPORT CODES

Abbreviations	
JFK	John F. Kennedy Airport, New York
JHB	Senai International Airport
KTE	Kerteh Airport
KUL	Kuala Lumpur International Airport
LCY	London City Airport, United Kingdom
LGA	LaGuardia Airport, New York
TGC	Tanjung Manis Airport

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INTRODUCTION

As with many other sectors in the economy and the aviation services sector in other countries, the Malaysian aviation services sector too has undergone significant liberalization. Liberalization, or the reduction of constraints on aviation services enterprises, was achieved through negotiating for greater ATRs[1] and other liberalization measures; introducing and promoting competition in the market; as well as, promoting both private and foreign ownership. Indeed, market liberalization has benefited consumers who now enjoy more choices through increased connectivity and lower airfares:

- Passenger traffic has increased from 65.3mn 2011 to 102.5mn in 2018.
- As of 2018, Malaysia was connected to 128 international destinations, ranking fourth in ASEAN after Thailand, Singapore, and Indonesia.
- The average airfares for Malaysian carriers had been on the downward trend for both domestic and international airfares from 2011 to 2018. The average domestic airfares decreased from RM245 in 1Q11 to RM215 in 4Q18 while the average international airfares decreased from RM570 to RM467 for the same period.

Despite these achievements, more can and needs to be done to ensure that the benefits of market liberalization continue and are sustainable for the long term. This Paper aims to state MAVCOM's position and recommendations in addressing the issues and challenges identified in market liberalization for the aviation services sector.

This Paper is organised as follows:

- **Section 1** details the sector liberalization in terms of opening the market to competition. This section first looks at the experiences of selected international jurisdictions—Australia, the UK, and the US—before discussing the Malaysian experience in liberalizing its aviation services sector.
- **Section 2** focuses on sector liberalization in terms of ownership liberalization via privatization of SOEs and subsequently, the promotion of both private and foreign ownership in aviation-related enterprises at international and national levels. This section observes that there are many different forms of ownership structures including common ownership of enterprises in the sector.
- **Section 3** discusses the various economics-based regulatory instruments that are implemented post-liberalization and deregulation of the sector, internationally and domestically. This section also highlights the various economic regulatory instruments that are under the purview of MAVCOM, as well as, general economic regulatory instruments of other bodies and authorities.

[1] An in-depth discussion on this can be found in MAVCOM (2018).

- **Section 4** provides MAVCOM's position and recommendations to address the issues and challenges of sector liberalization. These include recommendations and action plans to:
  - address **policy gaps** and keep policies updated;
  - ensure that **good governance** is practised and promoted;
  - ensure that **regulatory instruments** are updated; and
  - appreciate the pace and **consequences of liberalization**.
- **Section 5** concludes.

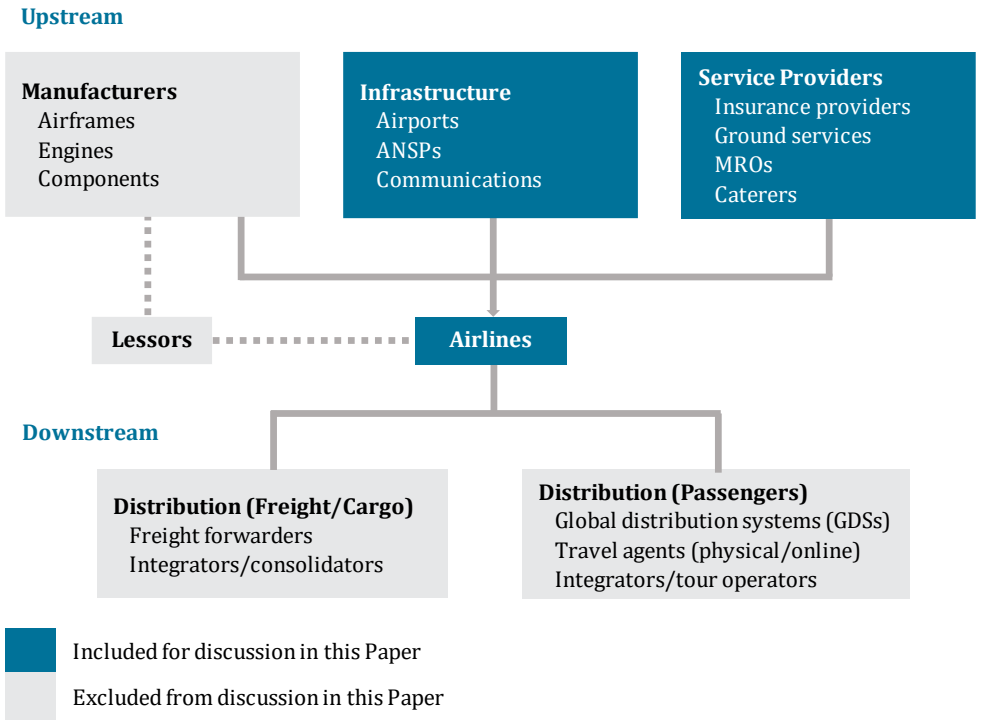
SECTION 1: INTRODUCING AND PROMOTING COMPETITION IN THE AVIATION SERVICES SECTOR

The aviation services sector has a long history of liberalization. Indeed, its liberalization and subsequent deregulation had paved the way for other sectors in the economy—notably, telecommunications and energy—to undergo a similar process. This section discusses the liberalization of the aviation services sector experienced in selected international jurisdictions—Australia, the UK, and the US—comparing them with the Malaysian experience. To start with, it is important to look at the aviation services sector value chain, which serves as the focal point of this Paper's discussion and analysis.

The Aviation Services Sector Value Chain

The aviation services sector value chain comprises sub-sectors in the upstream and downstream segments, which are linked by the airlines as a central node (see Figure 1).

Figure 1: The Aviation Services Sector Value Chain



Source: Tretheway and Markhvida (2013)

The upstream services sub-sectors can be categorized into four main areas:

- Manufacturers of aircraft and its components such as Boeing, Airbus, and Rolls-Royce
- Financiers such as leasing companies such as AerCap Holdings N.V., General Electric Capital Aviation Services, and Dubai Aerospace Enterprise
- Infrastructure including airports, ANSPs, and other aviation communications such as Heathrow Airport Holdings, MAHB, Royal Schiphol Group, NATS Limited, NAV CANADA, and Aviation Communication & Surveillance Systems, LLC
- Service suppliers or providers including the caterers; ground-handlers (such as for ramps, fuels, and baggage handling); maintenance, repair, and overhaul services for aircraft; and insurance services. Examples include LSG Sky Chefs, SATS Ground Team Red Holdings Sdn. Bhd., Brahim's SATS Food Services Sdn. Bhd., and Petronas Dagangan Berhad

Meanwhile, the downstream services sub-sectors can be categorized into two main areas:

- Distribution of passengers, which is assisted by the GDSs, travel agents, and travel integrators. Both travel agents and travel integrators can operate online or via brick-and-mortar offices. Examples include Amadeus, Sabre, Mayflower Holidays, and Expedia
- Distribution of cargo, which is undertaken by freight forwarders and cargo integrators. Examples include DHL, FedEx, and MASkargo

Linking both the upstream and downstream services is the airlines, which operate internationally, regionally, and domestically. Airlines have many different business models including full-service carriers and LCCs. Examples include Lufthansa, Etihad Airways, Malindo, Ryanair, and Cathay Pacific Dragon, among others.

The Liberalization Experiences of Australia, the UK, and the US

This paper focuses on the experiences of these three international jurisdictions in their efforts to liberalize and subsequently deregulate their markets. These jurisdictions were chosen as they are among the most mature in the world in terms of their liberalization and deregulation activities. Additionally, they have significant influence in market and regulatory developments internationally, including Malaysia.

Aviation Services Viewed Similarly to Public Utilities

Up to the 1970s, the aviation services providers or enterprises were viewed as having similar functions as any other public utility enterprises, providing social goods to the public.[2] Hence, governments and policymakers had prioritized their functions as enablers to the economy, rather than as revenue generators. For example, Qantas was operating Australia's air mail and flying doctor services in its early days. Meanwhile, in the US, airlines were recognized as playing a key role in the interest of the postal service and national defence for the country. Additionally, governments had viewed the provision of transportation services by airlines in rural and underserved areas as crucial in promoting social cohesion and economic development.[3]

Competition was not a Priority in the Early Years

In the early years, governments had implemented policies which differentiated or segmented their airlines sector into the international and domestic or interstate markets. There was more competition in the international markets which were serviced by many airlines. However, in the domestic or interstate markets, airlines were viewed as being similar to public utility enterprises. As such, the governments' focus was on the stability and reliability of service rather than on promoting competition in the domestic market. Subsequently, governments were not averse to subsidizing their airlines, regardless of whether they were publicly or privately owned, to ensure their services were not disrupted due to any financial distress.

In the case of Australia, its government had strictly enforced the "Two Airline Policy" for its domestic or interstate market from the end of World War II up to 1990. During these years, competition was limited to only two players, that is, between the government-owned airline, the Trans Australian Airlines and a privately-owned airline, Australian National Airways. The number of players were limited to avoid "wasteful competition". As part of this policy, the government had undertaken strict control and monitoring over the airlines' capacity and regulation of airfares.[4] There was also strict control imposed by four of the six states in Australia (except for Victoria and South Australia) on regional and local aviation markets.[5]

[2] Dempsey (1987) and Transportation Research Board (1991).
[3] *Ibid.* Transportation Research Board (1991).
[4] Forsyth (2017).
[5] Starkie (2008).

As for the US, the Congress was concerned that airlines were engaging in "destructive and excessive competition", which may have the effect of driving investments away from the sector, as well as, affecting labour and safety standards and safety of operations.[6] Indeed, the promotion of competition was secondary to the public interest objective in these jurisdictions. The Civil Aeronautics Act of 1938 stated that the certificates and permits issued to airlines to control their fares, routes, and other activities were exempted from the application of the Sherman Act (the US' antitrust law). Additionally, certificate- and permit-holders were required to pass the "public convenience and necessity" and public interest tests, respectively. Any consolidation, merger, and acquisition of control were also required to pass the public interest test. The Civil Aeronautics Act of 1938 also stated that competition matters were to be investigated based on the fair competition principle, which focuses on unfair and deceptive practices, as well as, public interest.

While the US regulated competition in its domestic market via certificates and permits, the UK favoured a licensing system.[7] This was first introduced with the enactment of the Air Navigation Act 1919 and expanded in later legislation including the Air Navigation Act 1936 and the Air Transport Licensing Act 1960, which established the Air Transport Licensing Board.

The licensing system was supported by a subsidy scheme which was made available to all airlines in the market regardless of their ownership. The main objective of the subsidy scheme was to support airlines operating on international routes.[8] As with the US Government, the UK Government was also concerned with "cut-throat competition". In its 1969 Civil Aviation Policy, the UK Government recognized the need for financial and managerial strength to maintain safe and efficient airline operations, thus limiting the number of privately-owned airlines in the market.[9] This policy remained up to 1972 when the UK Government continued to restrict the number of licences issued to British airlines aiming to serve additional international scheduled routes. This was to protect airlines under the British Airways Board, as well as, British Caledonian Airways, the designated principal providers and principal independent provider of scheduled airline services, respectively.[10]

[6] See above 2. Dempsey (1987).
[7] Baldwin (1985).
[8] Lyth (2000).
[9] UK Government (1969).
[10] UK Government (1972).

Introducing Competition Into the Aviation Services Market

The US was the first major jurisdiction that liberalized its aviation services market with the enactment of the Airline Deregulation Act of 1978. However, deregulation for the sector was already well underway from 1975 as the US Government abolished its economic regulations, which regulated fares and routes. The Airline Deregulation Act of 1978 expanded on these earlier reforms by promoting competition as existing air carriers moved into each other's markets—intrastate to interstate and vice versa; chartered service to scheduled service—and new airlines entered the market. Airlines were grouped as "majors", "nationals", and "regionals", according to their revenue size.[11] Between 1978 and 1985, the number of airlines operating major routes increased from 36 to over 120.[12]

Apart from encouraging new entrants into the domestic market, deregulation also resulted in airlines with new business models flying interstate. For example, Southwest Airlines, which commenced operations in 1967 as an LCC operating within Texas, expanded its operations interstate in 1979. The deregulation also resulted in the development of the hub-and-spoke system by major carriers, which was aided by extensive merger and acquisition activities (major carriers acquiring national and regional carriers). Additionally, the deregulation of airfares resulted in the development and significant use of the CRSs and proliferation of travel agencies.

Airports, which were long considered to be natural monopolies, were also influenced by changes in the airlines market due to the deregulation. Post-deregulation, airports also had to compete for airlines and passengers as the deregulation of routes meant that passengers have more choice of airlines and airports. Meanwhile, LCCs had resulted in the development of smaller and secondary airports.

The effects of deregulation and liberalization were not confined to the US aviation services sector. Similar implications and outcomes were also experienced in other jurisdictions that underwent similar deregulation and liberalization process. Australia ended its "Two Airline Policy" for its interstate markets in 1990. Since then, Australia's interstate markets have been served by national and regional carriers including Ansett Australia[13], Qantas, Jetstar, Virgin Australia, Tigerair, and Rex, among others. While Qantas made SYD, which is the largest airport in Australia, as its hub, Tigerair and Virgin Australia made MEL and BNE, which are the second and third largest airports in Australia, respectively, as their main hubs.

[11] See above 2. Transportation Research Board (1991).
[12] Hanlon (2007).
[13] Ceased operations in 2001.

Meanwhile, the UK liberalized its aviation services sector in 1993 and saw the entry of new airlines since then, which include EasyJet UK, Ryanair UK, Wizz Air UK, TUI Airways, and Thomas Cook Airlines, among others. As with the development in the US, some of these UK-based airlines are LCCs and they operate out of secondary airports in London and the rest of the UK. For example, LTN is a hub to EasyJet UK, TUI Airways, and Wizz Air UK, while Thomas Cook Airlines' main bases are MAN and LGW.

The Liberalization Experience of Malaysia

Malaysia's aviation services sector liberalization experience in the past was consistent with its industrial policy's objectives of developing, establishing, and nurturing national champions in selected strategic industries. Promoting competition in the market was not the main priority for the GoM then.

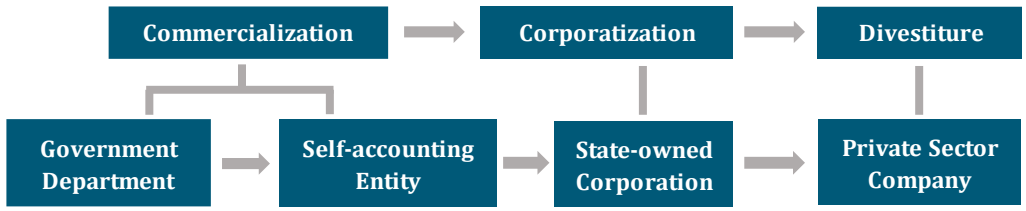
Privatization Policy Provided Impetus for Sector Liberalization

The impetus for liberalization in the sector was the introduction of the privatization[14] policy in 1983. This was part of the wider Malaysia Incorporated (Malaysia Inc.) policy, which was developed to promote the increasing role of the private sector in the Malaysian economy. In 1985, the GoM launched the Guidelines on Privatization, which had five main objectives:

- Facilitate economic growth
- Relieve the financial and administrative burden of the Government
- Improve efficiency and productivity
- Reduce the size and presence of the public sector in the economy
- Help meet the restructuring objective of the National Development Policy

This was followed by the publication of the "Privatization Masterplan" in 1991. In these documents, the GoM had identified entities in the transportation sector (including in the aviation sub-sector) to undergo the commercialization, corporatization, and subsequently, privatization process (see Figure 2).

Figure 2: Stages of Privatization in Malaysia



Source: Privatization Masterplan 1991

[14] Privatization can be defined as either the ownership transfer of entities/assets/shares from government-owned to privately-owned or the change from being publicly traded/listed on the stock exchange to privately traded/delisted. While MAS had undergone both exercises of privatization—in 1985 and 2014—unless otherwise stated, privatization in this paper refers to the first definition.

Introducing Competition Into the Malaysian Aviation Services Sector

Up to the late 1980s, the Malaysian domestic airlines market was mainly serviced by its flag carrier, MAS[15], which was first established as Malayan Airways Limited in 1947. It was renamed Malaysian Airways (1963), Malaysia Singapore Airlines (1966), and MAS (1972), reflecting political developments in the country. There was another airline servicing East Malaysia, known as Borneo Airways[16] but this was later absorbed into Malaysian Airways in 1965. Airfares were regulated by the GoM and from 1983 to 1990, domestic airfares were fixed.[17]

Subsequent to the implementation of the privatization policy, two airlines entered the domestic market—Pelangi Air (1987) and Berjaya Air (1989). These were later followed by AirAsia (1996) and Malindo (2013). Pelangi Air ceased operations in 2001 while Berjaya Air was a valid ASL holder up to March 2017. MAG also has a wholly-owned subsidiary, Firefly, operating since 2007.

Apart from these scheduled operators, the Malaysian domestic market is also serviced by non-scheduled operators. These ASP holders provide services for passengers and cargo, as well as, for other works such as aerial work including cloud seeding and mapping. As of June 2019, there were 18 ASP holders and they include companies such as PLUS Helicopter Services Sdn. Bhd., Myballoon Adventure Sdn. Bhd., Sabah Air Aviation Sdn. Bhd., and Pos Asia Cargo Express Sdn. Bhd.

As regards the regional and international routes, MAS, AirAsia, and Malindo competed with other regional and international airlines. Indeed, the regional and international airlines markets have always been competitive as supported by the ATRs both at bilateral and regional bases in the ASAs. As at June 2019, there were 69 airlines operating both scheduled and non-scheduled services to and from Malaysia. These airlines include large international airlines such as British Airways, Emirates, and Etihad Airways, as well as, regional airlines such as Cathay Dragon, and LCCs such as Jetstar Asia and Cebu Pacific Air.

In the case of airports, the GoM has privatized the operation and management of airports in Malaysia. MAHB is the largest airport operator in Malaysia as it was licensed to operate and manage 39 out of 42 airports.[18] Apart from MAHB, there are also other airport operators managing and maintaining airports in Malaysia. These are:

- **Senai Airport Terminal Services Sdn. Bhd.**, operating JHB and KTE
- **Tanjung Manis Development Sdn. Bhd.**, operating TGC

[15] MAB was established as part of the MAG on 1 September 2015 after MAS was delisted from Bursa Malaysia following its post-restructuring programme in 2014 and ceased of operation on 31 August 2015. In this report, the national carrier will be referred to as MAS for pre-2015 discussion and MAB for post-2015 discussion.

[16] Borneo Airways was first known as Sabah Airways Limited, which was established in 1947.

[17] Jomo and Tan (2005).

[18] MAHB operates the airports via its fully-owned subsidiaries, Malaysia Airports Sdn. Bhd. And Malaysia Airports (Sepang) Sdn. Bhd. For ease of reference, this Paper will refer to MAHB as a single operator, unless otherwise stated.

Of the many aviation services sub-sectors, the ground handling services sector has the largest number of players. Prior to MAVCOM's establishment, there were 65 ground handlers operating in Malaysian airports. The number has since been reduced to 31 by end-2018 . They operate as caterers (3), general ground handlers (19), and refuelers (8). Examples of the larger ground handlers in Malaysia include AeroDarat Services Sdn. Bhd., Brahim's SATS Food Services Sdn. Bhd., KLM Line Maintenance Sdn. Bhd., PETRONAS Dagangan Berhad, and POS Aviation Sdn. Bhd.

SECTION 2: OWNERSHIP LIBERALIZATION IN THE AVIATION SERVICES SECTOR

Apart from introducing competition, sector liberalization was also undertaken by changes in the ownership of aviation services enterprises. This took place by:

- transferring ownership from government to private sector players; and/or
- transferring ownership from domestic to foreign players.

It must be noted, however, that ownership structures are not binary (either full government or full private ownership). Rather, there is a spectrum of various ownership structures, with full government ownership at one end and fully private enterprise at the other. Additionally, foreign investors could also own parts of the local aviation-related enterprises. Finally, a holding enterprise may own aviation-related enterprises at different levels of the sector value chain (vertical ownership) or at the same level in the value chain (horizontal ownership).

As in Section 1, this section discusses the ownership liberalization of the sector experienced in Australia, the UK, and the US and compares them with the Malaysian experience. To start with, it is important to look at the different forms of ownership structures that are currently in practice.

Different Forms of Ownership Structures

Aviation-related enterprises can have different forms of ownership structures:

- **Full government ownership:** an aviation-related enterprise can be fully owned by the government
- **Partial government ownership:** an aviation-related enterprise can have partial government-ownership as government undertakes partial privatization exercise
- **Private ownership:** an aviation-related enterprise can be owned by shareholders from the private sector, including both institutional and retail investors
- **Local ownership:** an aviation-related enterprise can be owned by locals. Percentage of local ownership can be up to 100%
- **Foreign ownership:** an aviation-related enterprise can be owned by foreign nationals. There are usually limitations to foreign ownership depending on a country's foreign investment (ownership) policy

Ownership Liberalization Experiences in Australia, the UK, and the US

The introduction of competition into the aviation services markets in Australia, the UK, and the US, follows a similar path: in the early years, governments of these jurisdictions viewed competition negatively (wasteful, destructive, excessive, cut-throat) and so they had enforced strict economic regulations to control the entry of new players into their markets. This later changed as they deregulated their markets and allowed for competition in their markets.

Different Pathways to Ownership Liberalization

There is no similar trend in the case of ownership liberalization experiences of Australia, the UK, and the US. Both Australia and the UK nationalized their airlines in the early days of their aviation services markets. Qantas, founded in 1920 and later merged with UK's Imperial Airways, was initially privately owned before it was nationalised in 1947 by the federal government. Meanwhile, British Airways came into operation in 1974 after the formation of the British Airways Board, which was an outcome of the Civil Aviation Act 1971. The British Airways Board combined the management of two airways, the British Overseas Airways Corporation and British European Airways Corporation. While British Airways was an SOE, its predecessors started as private enterprises before being nationalized. The Australian and UK experiences can be contrasted with that of the US in which all of its airlines—even its flag or major carriers—have always been privately owned.

As regards airports in these jurisdictions, they were mainly SOEs right from the beginning.[19] In the case of Australia, its airports were operated by the state-owned Federal Airports Corporation from 1988 to 1997. In 1996, the Government decided to privatize the 22 airports under the Corporation, following the UK's airport privatization exercise. Earlier in the UK, the UK Government had passed the Airports Act 1986, which provided for the BAA to be privatized via share flotation in 1987. Additionally, the Airports Act 1986 provided for the corporatization of large airports[20]. There is also LCY which has always been privately owned. In contrast, the US has yet to embrace privatization for its airports and most of its airports are still owned at the local government level—cities, municipal councils or counties—or by public organization such as port or airport authority.[21] For example, both JFK and LGA are owned by the city of New York and operated by the Port Authority of New York and New Jersey.

[19] Information in this paragraph is based on Graham (2013).
[20] Defined as airports with an annual turnover exceeding £1million.
[21] Graham in Forsyth, Gillen, Knorr *et al.* (2004).

Foreign Ownership in Aviation-Related Enterprises

The US Government could be viewed as having the most liberal ownership for its airlines as they have been privately owned all this while. Upon closer inspection, however, this does not extend to the foreign ownership of US airlines. So far, foreign ownership is limited to 25% of share equity and airlines must be effectively controlled by US citizens. Also, two-thirds of the airlines' board of directors and their chief executive officers must be US citizens. While there had been past efforts to increase the foreign ownership limit, these had been met with much resistance especially by the labour unions who cited national security and strategic industry concerns to maintain the status quo. However, this does not stop US airlines from undertaking cross-border ownership of foreign airlines (see Box 1 on the case of Delta Airlines).

Box 1. Delta Airlines: An Example of a Cross-border Ownership

Along with the trend towards liberalization, the airline industry has continued to undergo major structural transformation to adjust to the dynamic marketplace of the industry. Airline strategy and planning have been increasingly focused on alliances, consolidation, and cross-border equity investments to exploit network-based economies of scale and scope.[22]

Delta Airlines has developed strategic relationships with certain airlines through equity investments and other forms of cooperation and support. Delta Airlines does not only have an equity stake and contractual arrangements with regional carriers such as Endeavor Air, Inc.,—a wholly owned subsidiary of Delta Airlines—the airline also has an equity stake in foreign carriers in other parts of the world through cross-border equity investments (see Table 1).

Table 1: Delta Airlines Equity Investments

Airlines	Equity Stake (%)	JV Agreement with Delta Airlines
Aeromexico	49.0	Yes
Virgin Atlantic Airways	49.0	Yes
Republic Airways	17.0	-
Air France-KLM	10.0	Yes
GOL Airlines	9.0	-
China Eastern	3.0	Yes

Source: Delta Airlines 2017 Annual Report

Through its cross-border equity investments, Delta Airlines has improved its access to international markets. For example, the demand created by Delta and Air France-KLM's combined customer base and hub airports has enabled new trans-Atlantic routes to give Delta customers expanded choice in destinations and flight frequencies.

[22] ICAO (2016).

Instead of taking a majority stake or pursuing a full-scale merger, cross-border equity investments have often been carried out as part of a strategy to forge or strengthen alliances on a limited scale. Delta Airlines has conducted commercial JV with certain foreign carriers that is under its cross-border investments as shown in Table 1. Typically, the JV agreement would include joint sales and marketing coordination, co-location of airport facilities, and other commercial cooperation arrangements.

In the case of the UK, the foreign ownership limit for its airlines is set at 49%, consistent with the EU foreign ownership limit for airlines. Australia does not have any foreign ownership limit for airlines operating in its domestic or interstate market but there is a cap of 49% for airlines operating in its international market.

Ownership Liberalization as Part of Malaysia's 1983 Privatization Policy

Apart from introducing competition into the market, Malaysia's privatization policy was also responsible for the ownership liberalization in its strategic sectors, including the transportation sector in general and the aviation services sector in specific. Indeed, MAS was the first SOE to be privatized in October 1985 (see Box 2 for more details).[23]

[23] See above 17.

Box 2. Privatization of MAS

MAS was incorporated under the Companies Act 1965 [Act 125] in 1971. Although it was 100% owned by the GoM, the operational decisions of the company were independent of the Government. This was termed an off-budget agency of the government, whereby the company has its own employment policies, salary scheme, and arranges its own funding without access to any government loans. MAS had a unique mandate to provide cheap and efficient air transportation for domestic travel whilst at the same time becoming a self-sufficient, competitive, and profitable airline in the international sector. Its domestic service also incorporated elements of PSOs as it had to connect underserved, rural areas to the rest of Malaysia.

Given these conflicting objectives, the company was subjected to a few institutional and governance arrangements. Appointments to the Board of Directors of MAS were initially made by the GoM. The Board consisted of top civil servants from the MOT, the DCA[24], the MOF, and the State Governments of Sabah and Sarawak. The company was regulated by the DCA and the MOT on issues such as landing rights and air safety. Major company decisions such as the acquisition or disposal of assets, mergers or takeovers and increases in fares also required the GoM's consent. Losses incurred by the company on RASs were compensated by the government if the company achieved a profit level of less than 15% of its share capital.

In the 1980s, when Malaysia embarked on a privatization plan, MAS was the first SOE chosen to be privatized as it was already a corporate body. In October 1985, the company was privatized through a partial divestment exercise. Its privatization prospectus outlined these four objectives[25]:

- To implement the government's policy of privatization
- To provide an opportunity for government-approved institutions, Malaysian investors and eligible employees of MAS and its subsidiaries to participate in the equity of the enterprise in accordance with the objectives of the New Economic Policy
- To raise capital for the MAS fleet expansion
- To obtain a public listing for the enterprise

Pre-privatization, 90% of the share ownership of MAS were with MOF Inc., 5% with the State Government of Sabah, and 5% with the State Government of Sarawak. Post-privatization, the total share ownership by the government in the enterprise was reduced to 70% (MOF Inc.: 62%; State of Sabah: 4%; State of Sarawak: 4%). The remaining 30% of the share ownership were with Bumiputera institutions (11%), MAS employees (5%), and other Malaysians and companies (14%).

[24] The DCA was corporatized and is now known as the CAAM as of 19 February 2018. In this report, the authority/regulator will be referred to as DCA for pre-2018 discussion and CAAM for post-2018 discussion.

[25] MAS Prospectus (1985) as mentioned in Mokhtar (2008).

Government's "Golden Shares" in Aviation-Related SOEs

The GoM ownership in MAS included a RM1 Special Rights Redeemable Preference Share, more commonly known as a "golden share". This provided specific preferential rights to the GoM as detailed in the prospectus. In the case of MAS, the golden share enabled the GoM to control major decisions and critical operating decisions of the company and most importantly, to appoint six directors to the company's Board of Directors and to appoint the Chairman and the Managing Director. The 'golden share', however, does not carry any rights to vote at a general meeting but entitles the holder to attend and speak at the meeting.

The term "golden share" is not defined under the Malaysian Companies Act 2016 [Act 777] or case law. Instead, section 69 of Act 777 contains a general provision which states that:

"subject to the constitution of the company, shares in a company may:

(a) be issued in different classes;

(b) be redeemable in accordance with section 72[26];

(c) confer preferential rights to distributions of capital or income;

(d) confer special, limited or conditional voting rights; or

(e) not confer voting rights".

In technical terms, a golden share held by the government in a company is often categorized as a "special rights redeemable preference share". "Preference share" refers to "a share by whatever name called, which does not entitle the holder to the right to vote on a resolution or to any right to participate beyond a specified amount in any distribution whether by way of dividend, or on redemption, in a winding up, or otherwise".[27]

In Malaysia, the GoM holds golden shares in various companies through MOF Inc.[28], which is established under the Minister of Finance (Incorporation) Act 1957 [Act 375]. MOF Inc. invests in companies with the following stated objectives:

- To bridge the market gap where the private sector gives less investment priority, mainly due to huge initial investment costs and high market barriers
- To provide social services to the public such as public transportation and utilities services
- To stimulate economic growth by investing in strategic sectors such as technological research and development
- To attract local and foreign investors to invest in specific areas such as biotechnology, information technology and communication

[26] Section 72 of Act 77 contains provisions regarding the issuance and redemption of preference shares.
[27] Section 2 of Act 777.
[28] According to the MOF website, MOF Inc. holds a golden share in 33 companies, direct majority shareholding in 68 companies, and ordinary shares in 5 companies.

As regards golden shares specifically, the purpose of GoM's ownership of golden shares is to ensure that certain major decisions affecting the operations of the company are consistent with the policies of the GoM.[29] Based on a survey of public-listed companies[30] in which MOF Inc. owns a golden share, the rights conferred by the golden share are as follows:

- Right to appoint directors
- Right to attend meetings but not vote
- Right to redeem the special share at any time
- In the event of the winding up of the company, right to priority in the repayment of the capital paid up on the special share
- No right to participate in the capital or profits of the company

The creation and establishment of golden shares in Malaysia's SOEs were based on the experience of the UK. However, the use of golden shares in the UK has been abolished in view of inconsistencies with their competition law (see Box 3 on a detailed discussion on golden shares).

Box 3. "Golden Share"

What is a "golden share"?

"Golden share" is a colloquial term referring to the special rights held by a public authority in a company. Such special rights can be defined as:

> *"all legal arrangements that have the purpose of preserving the influence of a public authority on a privatized enterprise beyond the extent to which such influence would be afforded under general company law. These rights grant the authority powers that are otherwise available only to, or indeed go beyond that of, a majority shareholders"*[31].

The special rights are commonly vested by a special share or a special class of shares. A well-known example is the UK Government's holding of a £1 Special Share in the BAA in the privatization of the airport operator, which gave the Government control over certain key decisions. The rights conferred were clearly disproportionate to the value of the special share.

Originating from the UK, similar golden share schemes were also adopted in the Netherlands, Portugal, Italy, France, Belgium, New Zealand, Brazil, Turkey, and Indonesia, amongst others. As for the EU, a 2004 survey found that there were special rights in 141 EU companies in the telecommunications, electricity, gas, energy, postal services, banking, and insurance sectors.[32] The golden share scheme was used as a measure to:

[29] Based on the 2018 annual reports of MAHB, Telekom Malaysia, Pos Malaysia, and Tenaga Nasional Berhad.
[30] Bintulu Port Holdings Berhad, Telekom Malaysia, FGV Holdings Berhad, MAHB, MISC Berhad, Pos Malaysia Berhad, Tenaga Nasional Berhad, and Westport Malaysia Berhad.
[31] Oxera (2005).
[32] European Commission (2005). However, we note that in recent years, golden shares have declined in popularity in the EU in light of the infringement decisions of the European Court of Justice against golden share schemes in several Member States.

- maintain control of newly privatized companies while such companies adjust to the free market environment; and/or
- prevent foreign investors from taking over companies operating in strategic sectors.[33]

Special rights in a company can also be retained by a public authority through legislation, particularly privatization law, without the need to hold any shares in the company. Below are some examples:

- The Privatization Act 1993 in France gave the Government the right to oppose the sale of strategic assets and the transfer of share capital beyond 10% of the voting shares
- In Belgium, privatization laws allowed the Government to annul a canal transport and gas enterprise's board decisions regarding disposal of core assets
- The Italian Framework Law 1994 provided the Government with veto rights over certain management decisions in privatized companies
- Laws in Portugal limited participation of foreign investors in privatized companies

Types of golden shares

Golden shares or special rights can be categorized into direct or indirect investment restrictions.

Direct investment restrictions give a public authority the rights to control changes in ownership and influence the shareholder structure of a company. Such restrictions include:

- Caps restricting substantial blockholdings
- Power to approve or veto changes in ownership

Indirect investment restrictions grant a public authority with influence over a company's management decisions. Examples are:

- Power to approve or veto certain strategic management decisions
- Rights to approve or appoint board members
- Limitations of other shareholders' voting rights

In addition, special rights can also be divided between discriminatory and non-discriminatory restrictions. Discriminatory restrictions explicitly discriminate against foreign investment and are likely to have a more significant impact on cross-border investment. However, non-discriminatory restrictions may also affect cross-border investment by discouraging strategic investors who might otherwise be interested.

Golden shares under the EU law

The EU regulates golden shares extensively. In the EU, golden shares are not prohibited per se. However, the issue of golden shares has come under much scrutiny by the ECJ, which has been critical towards it.

[33] Koukounis (2018).

The discussion on golden shares in the EU relates to the functioning of the European single internal market.[34] Article 63 of TFEU prohibits restrictions on the movement of capital and payments between EU Member States, as well as, between EU Member States and third countries.

In general, any special right that discriminates against an EU Member State or its nationals is prohibited. In Commission v. Portugal[35], the ECJ held that the legislation which permitted the State to limit the shareholding of foreign entity was discriminatory and violated the free movement of capital.

Special rights that are non-discriminatory had also been found to be illegal for restricting the free movement of capital. In Commission v. Portugal[36], the ECJ considered the legality of Decree-Law 380/93, which required prior government authorization before any person could hold more than 10% of voting shares in a newly privatized enterprise. Even though the prior authorization requirement applied to all regardless of nationality, the ECJ found it to be incompatible with Article 63 of TFEU as it could potentially dissuade investors from other Member States, "rendering the free movement of capital illusory".

Despite the general prohibition against restrictions on the free movement of capital, the EU law allows its Member States to take measures that restrict the movement of capital and payments if such measures are justified on grounds of public policy[37], public security[38] or public interest[39], amongst others. Any justification claimed must be legitimate and proportionate, as illustrated in the following cases:

- In Commission v. France[40], issues arose on a legislation that created special rights to the Minister of Economic Affairs after the privatization of Société Nationale Elf-Aquitane, a petroleum enterprise. The law granted the Minister the right to appoint two board members and the right to oppose the sale of strategic assets. It also required prior authorization for any disposal of more than 10% of shares.

  The ECJ held that the legislation restricted the movement of capital. Noting that a Member State may adopt measures to safeguard against a genuine and sufficiently serious threat, the court found that the legislation's objective of safeguarding France's petroleum supplies was legitimate. However, it further held that the special rights were not proportionate to the said objective due to the lack of specificity and transparency—including on the prior authorization requirements—which promoted legal uncertainty due to the discretionary power of the State.

[34] "Internal market" refers to "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties".
[35] Case C-367/98 (2002).
[36] Case C-367/98 (2002).
[37] Article 65 of the TFEU.
[38] Article 65 of the TFEU.
[39] As established through case law.
[40] Case C-483/99 (2002).

- In Commission v. Belgium[41], the court considered the Belgian golden share scheme in relation to two privatized companies in the gas and energy distribution sector. The State had the right to be notified of any transfer of strategic assets and to appoint two board members for the respective companies. Those board members also had the power to suggest to the Minister of Energy for the annulment of a board decision on the basis that it would adversely affect national interests in the energy sector. If the Minister annuls a board decision, there was a right of appeal to the Belgian supreme administrative court.

  As with the Commission v. France case, the ECJ found the safeguarding of energy supplies to be a legitimate public interest. The court further held that the measures met the proportionality and legal certainty requirements due to four factors: the lack of a prior authorization system; the State's power to object was limited to the transfer of assets which could alter the energy supply networks; the Minister could only annul a board decision if it jeopardizes the Government's energy policy; and the right of appeal against the Minister's decision.

The ECJ decisions above demonstrated the strict EU legal framework governing State-vested golden shares or special rights in private companies.

Privatization of Airports

Unlike MAS, the airport operator has a more recent history of privatization. As mentioned earlier, up to 1991, the DCA was responsible for the operations, maintenance, and management of airports in Malaysia. In September 1991, the Airport and Aviation Services (Operating Enterprise) Act 1991 [Act 467] came into effect. This new law established a separate and new entity, Malaysia Airports, to take over from the DCA the responsibility of operating, maintaining, and managing airports in Malaysia. On 11 December 1991, Malaysia Airports Sdn. Bhd. was incorporated under the Companies Act 1965 as a wholly-owned subsidiary of MOF Inc. It was subsequently transferred to KNB, which is also a wholly-owned subsidiary of MOF Inc. In 1999, the enterprise went for public listing.

As in the case of MAS, the GoM, via MOF Inc. and KNB, remained the majority shareholders of the airport operator, now known as MAHB, with at least 36.7% share ownership. Part of the GoM's ownership also includes a golden share "to ensure that certain major decisions affecting the operations of the enterprise are consistent with Government policies".[42]

The privatization and liberalization activities in the aviation sector replicated those of other strategic sectors in Malaysia. An example would be the telecommunications sector, which is detailed in Box 4.

[41] Case C-503/99 (2002).
[42] MAHB (1999).

Box 4. Liberalization of the Malaysian Telecommunications Sector

One sector that underwent extensive liberalization between the 1980s and 1990s was the telecommunications sector. The GoM allowed for competition in the supply of telecommunications equipment, value-added networks, radio paging, and mobile cellular. The GoM also attempted to introduce competition in the fixed telecommunications market by issuing licences for five new entrants between 1993 and 1995, three years after the incumbent operator, Syarikat Telekom Malaysia Berhad (later known as Telekom Malaysia Berhad or TM), was listed on the local stock exchange, and six years after it was corporatized and subsequently privatized.

Whilst embarking on the privatization exercise, the GoM also liberalized several key sectors in the economy in the 1990s. For example, the GoM issued licences for new mobile telecommunications operators, thus introducing competition into the market. These operators also faced rapid technological changes, which influenced consumer demand.

The privatization exercise also decoupled the regulatory and operational functions of the telecommunications services. Before 1987, the Telecommunications Department of Malaysia (commonly known as Jabatan Telekom Malaysia or JTM) was both the regulator and operator of the telecommunications services, reporting to the then Ministry of Energy, Telecommunications and Posts. Post-privatization, JTM retained the sector regulation function while the new entity, TM, took over the commercial and operational functions of the telecommunications services. The Ministry retained its power to issue licences.

In 1994, the Ministry introduced the national telecommunications policy which provided sector recommendations up to the year 2020. In 1998, the Ministry underwent a major restructuring to become the Ministry of Energy, Communications and Multimedia. During the same year, the Communications and Multimedia Act 1998 [Act 588] and the Malaysian Communications and Multimedia Commission Act 1998 [Act 589] came into force. In 1999, the Malaysian Communications and Multimedia Commission was established to regulate the industry via Act 588.

So far, Malaysia has yet to liberalize the ownership of its ANSP, which is currently under the purview of CAAM (see Box 5).

Box 5. Examples of Ownership and Control Structures of ANSPs

There are several ownership and control structures that are typical for the operations of ASNPs. [43]

Government ownership and control

Most ANSPs are government departments, usually civil aviation administrations that operate on an annual budget allocated by the government. The government retains control over air navigation services charges. Decisions involving major purchases or investments in facilities and equipment would normally be subject to the government's approval process and treasury rules. These may also compete with other claims for government funds.

The government plays both the role of regulator and service provider. This close relationship between the regulator and the service provider can result in conflicts of interest and undermine public confidence in the system. The overlap in the regulatory and operational functions may lead to diffused accountability relationships within the entity.

Studies demonstrate that most governments favour maintaining control over air navigation services because their provision generally extends over the entire territory of the country concerned. Additionally, air navigation services have national defence and external relations implications with respect to the country's sovereign airspace.[44]

Government-owned autonomous entity

An autonomous air navigation services entity is an independent entity established for the purpose of operating and managing air navigation services, which is empowered to manage and use the revenues it generates to cover its costs. Creating legal entities outside the government is usually called "corporatization".

The extent to which the government-owned autonomous ANSP can function like a private sector company depends on the degree of autonomy conferred to the entity. The autonomous ANSP can still be subject to government's directions or pressure to consider the wider public interest. It may also be required to adhere to government approval processes for major capital investment. Alternatively, the autonomous ANSP can be allowed to commercialize some or all of its activities.

[43] ICAO (2012).
[44] ICAO (2013).

It is often beneficial to establish an autonomous civil aviation authority to take over the functions previously performed by a civil aviation administration, including the operation of air navigation services. The establishment of an autonomous civil aviation authority could permit the government to obtain benefits such as increased efficiency and a significant reduction of the contribution from public funds previously required for the civil aviation administration, which the civil aviation authority would replace.

In Malaysia, the DCA—a department under the MOT—was corporatized to become CAAM on 19 February 2018.

Private ownership and participation

In recent years, several government-owned autonomous ANSPs have been commercialized and expected to operate as financially independent business entities and to be competitive, efficient, and cost-effective. Allowing private ownership may be driven by diverse motives, ranging from improving operational efficiency and reducing costs to a more pragmatic desire to relieve the government's fiscal burden.

Private participation and involvement have meant that the private sector has a role in the ownership, control, and/or management of an ANSP but the majority or ultimate ownership could still remain with the government. To date, private participation/involvement in ANSPs is minimal, and there have been only a few cases of PPPs. The advantage of a PPP is that the management skills and financial acumen of private businesses could create better value for money for taxpayers when proper cooperative arrangements between the public and private sectors are used.

There are few cases where the ownership of such commercialized ANSPs has been transferred partly or fully to the private sector:

- Canada privatized its air navigation services through NAV CANADA, a not-for-profit organization that is monitored by airlines through membership on the board of directors. It is unique as it has no shareholders and does not have to pay dividends.
- In the UK, NATS Limited was established as a PPP in 2001 and is owned 49% by the government, which also maintains a golden share, 42% by the Airline Group, a consortium of UK airlines, 5% by its employees, and the remaining 4% by the airport operator, BAA.
- There is minor participation of airlines in the equity of Thailand's air navigation services, AEROTHAI, for historical reasons, and the government controls the charges.

Mixed Ownership Structures in Aviation-Related Enterprises

As with the experiences of Australia, the UK, and the US, the Malaysian aviation-related enterprises have mixed ownership structures. The mixed ownership structures are not special to the aviation sector as evidenced in the experiences of enterprise ownership in other sectors such as telecommunications, energy, and utilities (water and postal services).

- **Full government ownership:** in the case of Malaysia, this could be at both the federal and state levels. For example, MAG is fully owned by KNB. An ASP holder, Sabah Air Aviation Sdn. Bhd. is owned by the State Government of Sabah and Sabah Energy Corporation Sdn. Bhd. Middle East airlines provide the equivalent international examples—Emirates, Etihad Airways, and Qatar Airways are fully-owned by the Governments of Dubai, Abu Dhabi, and Qatar, respectively. Emirates and Etihad Airways are part of larger holding companies, namely the Emirates Group and the Etihad Aviation Group, respectively.
- **Partial government ownership:** MAHB is partially owned by the GoM via its various government-linked investment companies including KNB, EPF, and LTAT. An international example would be Air New Zealand which has majority government shareholding at 52%. The remaining shares of the enterprise are listed on the New Zealand stock exchange.
- **Private ownership:** Both AirAsia and Malindo are privately owned airlines. At the international level, Lufthansa has 100% private ownership.
- **Local ownership:** Since MAG is fully owned by KNB, it has 100% local ownership. Similarly, Emirates, Etihad Airways, and Qatar Airways have 100% local ownership by virtue of them being fully-owned by their respective governments.
- **Foreign ownership:** MAHB, AirAsia, and Malindo have foreign ownership since they are listed on the stock exchange. Etihad Airways owned 29% equity shares in Air Berlin, a Germany-based airline.

Government Ownership to Address Market Failures

While the privatization and liberalization processes had encouraged and promoted participation of the private sector in the market, government may still play a significant role in business. Privatization could be an attempt to address the concerns on the role of government in business. However, the existence of SOEs and subsequently statutory funds with companies, highlight the reluctance to do away with such enterprises as an implementing tool of addressing market failures such as:

- **Natural monopolies:** competition may not result in an economically optimal outcome in certain industries as suppliers or producers cannot benefit from the economies of scale or scope of one supplier or producer—traditionally, airports were viewed as natural monopolies in view of its high infrastructure costs. As such, a government may prefer having SOEs instead of private natural monopolies to internalize the regulation of the dominant positions of these enterprises.
- **Capital market failure:** investment in certain sectors may be too risky for private sector investors and the local capital market may still be underdeveloped to provide the necessary financing to such investors. Hence, SOEs may be established to spearhead investment activities in such sectors.
- **Externalities:** private sector investors may be discouraged to invest in certain sectors as the private benefit accrued to them is lower than the social benefit. For instance, the high research and development costs in an intellectual property-related sector may prohibit the private investors from entering the market as they could not afford the long-gestation period to profit.
- **Equity distribution:** PSOs or universal service obligations in certain sectors such as telecommunications, postal services, and airlines may not be commercially justifiable. Thus, the government may prefer to establish SOEs, which can then be directed to provide such services to the underserved markets.

There are also the non-economic objectives that a government may consider in maintaining its role in business:

- **Nationalization:** there have been numerous cases in which entities that are previously owned by the private sector were nationalized to ensure that the relevant services or goods continued to be provided during periods of economic crises. For example, MAS was the first SOE to be privatized under the Malaysia Inc. programme in 1985. However, the losses incurred during the Asian Financial Crisis 1997 had resulted in the GoM buyback of shares in the airline. These shares were later transferred to KNB. In 2014, KNB announced a six-year MAS Recovery Plan which resulted in the delisting of MAS and the creation of MAG.
- **Fiscal revenue:** SOEs may also be established to raise revenue for the government while maintaining prudent expenditure management through off-balance sheet transactions. The government would receive revenue in the form of taxes and dividends from such entities, while their debt or financing would not be included in the official expenditure statement.

Common Ownership

Two aviation-related enterprises can also be under the same ownership. Common ownership can be at different levels:

- Common ownership either by the government or the private sector, including institutional investors
- Common ownership in the various parts of the aviation sector value chain, or common vertical ownership
- Common ownership of similar level enterprises/assets, or common horizontal ownership

An international example would be the Emirates Group which has aviation-related companies in the various sub-sectors including the Emirates (airlines), dnata (ground handling, cargo, travel, and catering), and Emirates Engineering (engineering services), among others.

Common Ownership in Malaysian Aviation-Related Companies

Some Malaysian aviation companies also have common ownership. MAG has 100% ownership of aviation-related enterprises organised into four business groups—air transportation services, ground services and engineering, aircraft leasing, and talent development. The aviation companies in the air transportation services business group for MAG include MAB, Firefly, MASwings, and MASkargo. The AirAsia Group controls the network of short-haul LCCs including AirAsia, Thai AirAsia, AirAsia India, Philippines AirAsia, AirAsia Japan, and Indonesia AirAsia, while the AirAsiaX Group controls the network of long-haul LCCs including AirAsia X, Thai AirAsia X, and Indonesia AirAsia Extra. Meanwhile, Malindo is part of the regional Lion Group which also owns Lion Air, Wings Air, Batik Air, and Thai Lion Air.

The aviation companies may also be vertically integrated by owning companies operating in the other parts of the aviation services sector value chain. Going back to the MAG example, it also owns AeroDarat Services Sdn. Bhd. which provides ground handling services—including ramp and cargo handling services—at 16 airports in Malaysia including KUL. Similarly, AirAsia also has a ground handling enterprise, SATS Ground Team Red Holdings Sdn. Bhd., which is a 50/50 JV with SATS Ltd. Meanwhile, MAHB has a wholly-owned subsidiary, MA Niaga Sdn. Bhd., which operates the duty-free and non-duty-free outlets, as well as, F&B outlets at the airports.

Another common trend, both domestically and internationally, is for institutional investors to own shares in aviation-related enterprises. Institutional investors include private and public funds such as private equities, insurance companies, hedge funds, exchange trade funds, asset management funds, sovereign wealth funds, and pension funds, among others.[45]

[45] For more details on institutional investors, see Çelik and Isaksson (2013).

Institutional investors can have common ownership in aviation-related enterprises within a country, as well as, across countries. For example, BlackRock, the world's largest asset manager in 2018, has shares in 21 aviation-related enterprises in 10 countries (France, Germany, Japan, Malaysia, Philippines, Singapore, Spain, Turkey, the UK, and the US). In Malaysia, institutional investors can simultaneously own shares in multiple aviation-related enterprises. For example, The Vanguard Group owns shares in AirAsia, AirAsia X, and MAHB, while Singapore's GIC Private Limited owns shares in AirAsia and MAHB. Malaysian institutional investors such as the EPF, KNB, and PNB also have shares in the major aviation-related enterprises (see Table 2).

Table 2: Partial List of Owners in Large Malaysian Aviation-Related Enterprises (as at 30 June 2019)

Equity Owner	%
AirAsia	
Tune Live Sdn. Bhd.	16.73
Tune Air Sdn. Bhd.	15.45
EPF	6.38
Skim Amanah Saham Bumiputera	4.75
The Vanguard Group Inc.	2.00
Dimensional Fund Advisors LP	1.64
BlackRock Inc	1.32
Saudi Arabian Monetary Authority	1.06
Amanah Saham 2	0.99
Prulink Equity Fund	0.91
The National Farmers Union	0.89
GIC Private Limited	0.77
Causeway Capital Management LLC	0.67
Amanah Saham Malaysia	0.65
Norges Bank Investment Management	0.64
AirAsia X	
Tune Group Sdn. Bhd.	17.83
AirAsia Bhd.	13.76
Kamarudin Bin Meranun	8.94
Lim Kian Onn	4.24
Bank Julius Baer Singapore Ltd.	4.23
Kenanga Investment Bank Bhd.	4.21
AIA Bhd.	3.58
Fernandes Anthony Francis	2.69
Citigroup Inc.	1.85
Dimensional Fund Advisors LP	1.74
The Vanguard Group Inc.	1.41
RHB Investment Bank Bhd.	0.65
UBS AG	0.56
State Street Corp	0.47
Skim Amanah Saham Bumiputera	0.37

Equity Owner	%
MAHB	
KNB	33.21
EPF	13.51
BlackRock Inc.	3.63
The Vanguard Group Inc.	2.07
Skim Amanah Saham Bumiputera	1.84
Citigroup Inc.	1.68
State Street Corp	1.38
GIC Private Limited	1.15
Sun Life Financial Inc	0.95
Van Eck Associates Corp	0.92
Dimensional Fund Advisors LP	0.91
Oversea-Chinese Banking Corp Ltd	0.88
Amanah Saham Wawasan	0.78
Prulink Equity Fund	0.76
AIA Bhd.	0.73
Brahim's Holding Bhd.	
Brahim's International Franchises Sdn. Bhd.	30.05
Urusharta Jamaah Sdn. Bhd.	19.28
IBH Capital (Labuan) Ltd.	10.58
Koperasi Permodalan Felda Malaysia Bhd.	2.91
Yayasan Sarawak	1.07
University of Malaya	0.82
Sharifah Bahiyah Omar	0.81
Yayasan Guru Tun Hussein Onn	0.81
Chai Yune Loong	0.70
Takaful Ikhlas Sdn. Bhd.	0.55
Batu Bara Resources Corp Sdn. Bhd.	0.44
Mohd Ibrahim bin Mohd Zain	0.44
Lim Siew Wah	0.44
Renesas Semiconductor Sdn. Bhd.	0.42
Jeannie Ooi	0.42

Source: Bloomberg

Managing the Drawbacks of Common Ownership

Common ownership has its advantages. For example, it could allow for cross-subsidization among the enterprises within the network. Indeed, this is currently practised by MAHB—while it aims to make all its airports profitable, this objective is difficult to achieve especially for certain airports operating in smaller or underserved areas. Hence, the more profitable airports are currently subsidizing the loss-making ones in its network. In the case of AirAsia, its common ownership with AirAsia X allows better integration of passengers' connectivity within its network of flights. Common ownership could also enable companies to benefit from economies of scale, access to capital, and better management of capacity and resources. Going back to the MAHB example, it centralizes some business functions at the holding company level. The best outcome would be for these enterprises to pass on any cost-savings to their customers via lower prices and greater service and efficiency.

However, common ownership may have its drawbacks, which include:

- **Subsidizing inefficient companies in the group/network:** while some companies with the group or network may be loss-making due to them having to perform social obligations—such as STOLports in rural areas—there could be cases where companies are loss-making because they are inefficient. Hence, cross-subsidization could have the unintended consequence of encouraging such companies to remain inefficient as they get to be subsidized by the more efficient companies in the group or network.
- **Allowing companies to undertake anti-competitive conduct:** common ownership may enable companies to undertake anti-competitive conduct when competing with their rivals in the market. For example, airports, airlines, and ground-handlers with common owners may give preference when providing goods and services—such as allocation and location of check-in counters and boarding gates—to their respective commonly-owned companies. Such discriminatory practices are anti-competitive as they provide an uneven playing field for competitors in the market. Additionally, competition authorities in other jurisdictions, notably the US and the EU, are becoming concerned over the potential corporate governance and anti-competitive implications of common ownership by institutional investors.

Box 6 provides a discussion on the competition-related issues arising from common ownership.

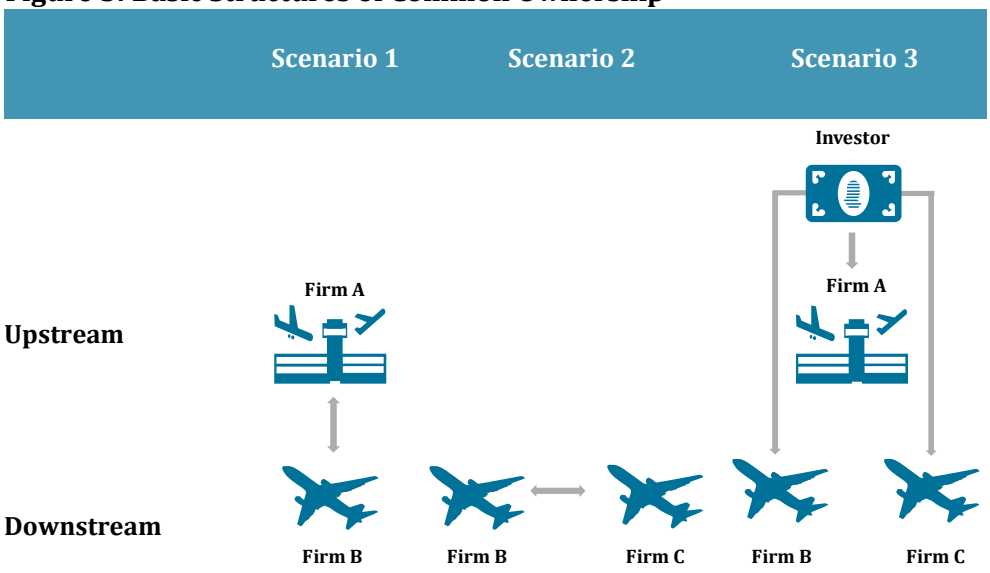
Box 6. Managing Competition Issues From Common Ownership

Types of common ownership and arising competition issues

Common ownership covers a wide range of situations involving the ownership of shares by one individual or company in another company. Figure 3 illustrates the different basic structures of common ownership:

- **Scenario 1** shows a **vertical common ownership**, where a company in the upstream market (Firm A) owns shares in a company in the downstream market (Firm B), or vice versa. It also covers a situation where Firm A and Firm B own shares in each other's company, a situation known as cross ownership.
- **Scenario 2** shows a **horizontal common ownership**, where Firm B owns shares in Firm C (or vice versa) and both companies are competing in the same market. Similar to Scenario 1, it also covers circumstances where Firm B and Firm C engage in cross ownership.
- **Scenario 3** illustrates a situation where an investor owns shares in companies in the **same or different levels of the supply chain**. For example, an investor may own shares in an upstream Firm A and a downstream Firm B, or in competing companies in the same downstream market, i.e. Firm B and Firm C.

Figure 3: Basic Structures of Common Ownership



Source: MAVCOM

To add to the complexity, the extent of ownership in each scenario also ranges from holding a minority stake in the company rendering no control in the company, to an acquisition of majority shares in a company and having control over it. Accordingly, competition issues arising from common ownership also vary depending on the common ownership structure and the extent of control arising from it.

Common ownership with majority shareholding and/or control: this covers all three scenarios in Figure 3 above where a firm acquires the majority shares and/or control of other firm(s).

In general, a horizontal common ownership with majority shareholding and/or control raises serious competition concerns because it involves directly-competing companies. Among others, such a horizontal common ownership may result in the following anti-competitive effects:

- A horizontal common ownership may create or strengthen the dominance of the companies involved, enabling and incentivizing them to profitably increase prices or reduce quality, independent of the response of other firms in the market. This is more likely where the parties have large market shares and the barriers to entry/expansion are high, limiting the competitive constraints faced by them from other existing or potential competitors in the market.

  Example: Consider competing Airlines A, B, C, and D with 30%, 30%, 20%, and 20% market shares, respectively. If Airline A acquires Airline C and Airline D, it may be profitable to raise prices for Airline A as Airlines C and D may also gain from customers subsequently switching from Airline A. Such a strategy may increase the combined profits of Airlines A, C, and D.

- Common ownership may make it easier for all firms in the market to tacitly coordinate, resulting in higher prices. Such coordinated effects are more likely to occur in markets or industries that are susceptible to collusion, considering factors such as the number and market shares of companies, barriers to entry/expansion, market transparency, products' homogeneity, history of price coordination, the presence of a "maverick" firm, etc.

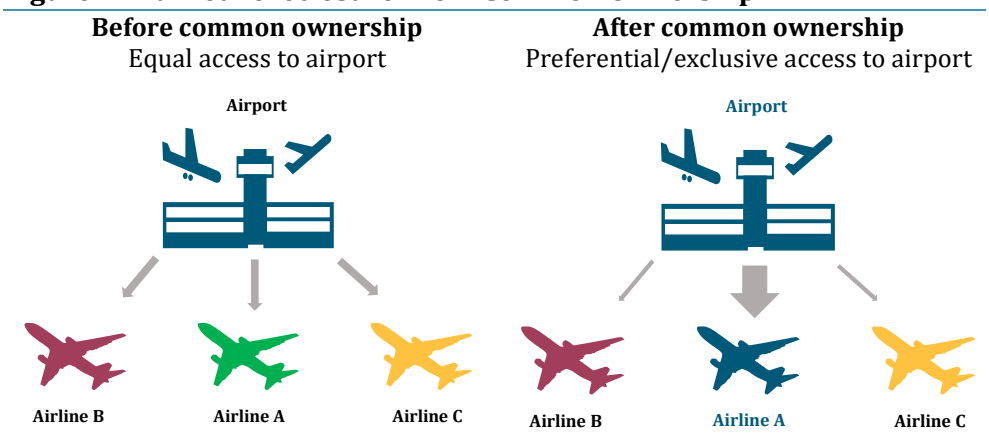
  Using the same example above, the acquisition by Airline A effectively reduces the number of firms competing in the market from four to two (with Airlines A, B, and C considered as one firm).[46] Coupled with the transparency of airfares, tacit collusion may be a likely outcome of such common ownership.

[46] In competition law, the concept of a "single economic unit" is commonly used. Companies with separate legal entities are regarded as a single enterprise if they are jointly controlled and do not enjoy autonomy in determining their actions in the market separately and independently of each other.

On the other hand, vertical common ownership with majority shareholding and/or control is generally regarded as benign or even pro-competitive. However, it may result in serious anti-competitive effects such as market foreclosure, especially where one company has dominance in the upstream or downstream market.

For example, where a dominant Airline A merges with or owns an airport, the airport may have the incentive and ability to refuse other airlines equal access to the airport facilities, assuming there is no alternative airport within the same catchment area. This may transpire in many forms, from giving preferential treatment to Airline A in terms of slot allocation and location of check-in counters, to outright refusal of access to competing airlines (see Figure 4). Such a strategy may be adopted to solidify Airline A's market power in the airline sector.

Figure 4: Market Foreclosure From Common Ownership



Source: MAVCOM

Common ownership with minority shareholding and no control: this includes the common practice of institutional investors owning minority shares in various companies at the same or different levels of the supply chain in an industry, including the aviation industry.[47] The anti-competitive effects of such institutional investor's behaviour are subject to much debates recently.

[47]OECD (2017). Such investments may be made for the following purposes: to diversify and spread costs and risks; to access new technologies or innovative managerial practices; to establish and strengthen business relationships; to access new markets; and to fund and exploit joint activities such as research and development.

One view is that horizontal companies with common shareholders may be incentivised to compete less aggressively than in the absence of such common ownership. Common ownership—even of minority shares—may give rise to unilateral effects or coordination between the companies.[48] Institutional investors may influence a company through voting and close interactions with the company's management and board members.[49] Also, the threat of selling shares may be sufficient to effectively influence management's decisions.[50]

Studies had found a positive and statistically significant correlation between common ownership and higher prices in the banking and aviation sectors:

- Azar, Schmalz, and Tecu (2017) studied the anti-competitive effects of common ownership in US airlines and estimated that common ownership increases airfares on the average US airline route by 3 – 5%.
- Azar, Raina, and Schmalz (2016) studied common ownership in the banking sector and concluded that common ownership was estimated to increase checking account fees and check account fee thresholds by about 5% and 10%, respectively.

In addition, Anton et al. (2016) studied the relationship between common ownership, competition, and top management incentives. The study estimated that "common ownership is correlated with executive compensation policies that may weaken the incentive for firms to compete aggressively."[51]

On the other hand, there are also views that the anti-competitive effects arising from common ownership by institutional investors are inconclusive. Contrary to the above, there are other studies that found no relationship between common ownership by institutional investors and anti-competitive outcomes, such as the following:

- In relation to the airline industry, studies by Kennedy et al. (2017) and Dennis, Gerardi, and Schenone (2018) analysed the relationship between common ownership and airline prices and found no evidence that common ownership raised airfares.
- Gramlich and Grundl (2017) analysed the competitive effects of common ownership in the banking industry using the same data as Azar, Raina, and Schmalz (2016) and found mixed preliminary results. It was concluded that the anti-competitive effect was not robust and small in magnitude.

[48] Klovers and Ginsburg (2018).
[49] OECD (2017). Institutional investors may be able to influence voting results despite not having an outright majority of shares, particularly where: shareholder meeting attendance and vote engagement are low; institutional investors own comparatively larger proportions of shares as compared to other shareholders; and institutional investors voting as a bloc.
[50] McCahery, Sautner, and Starks (2015). The study found that 49% of the investors surveyed stated that they had exited due to dissatisfaction with the performance in the past five years from the survey, and 42% believed that the exit threat is an effective tool to discipline the management. The effectiveness of the threat depends on "the investors' equity stake size, whether other investors [would] also exit for the same reason, managerial equity ownership, and whether other large shareholders are also present".
[51] See above 48.

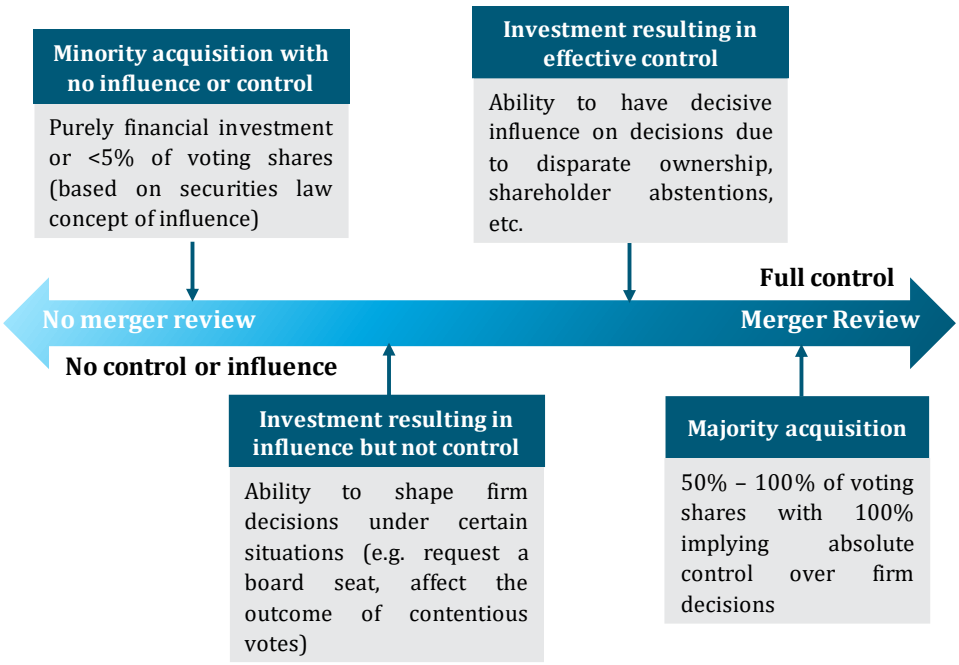
The ability of institutional investors to exert influence on companies has also been questioned. For example, in exercising voting rights, bloc voting by institutional investors may not be possible as their interests may not be aligned. Furthermore, O'Brien and Waehrer (2017) argued that performance-based compensation for management "gives a manager an incentive to maximize the profits of the firm", not "to take actions that increase industry profits at the expense of own-firm profit".

Thus, the competitive effects of common ownership by institutional investors remain open for debate.

Common ownership and merger control

Merger control regimes are commonly used as an ex ante measure to address issues relating to common ownership arising from a merger, in particular, where it results in ownership and/or control over a company. Figure 5 below shows the spectrum of control and influence resulting from an investment and the scope of merger review.

Figure 5: Ownership, Control, and Merger Review



Source: OECD

In Malaysia, merger control for aviation services is governed by Division 4, Part VII of Act 771. Subsection 54(1) of Act 771 prohibits mergers that result in a substantial lessening of competition in the relevant market. The merger control regime governs horizontal and vertical mergers resulting in the acquisition of direct or indirect control of an enterprise, among others.[52] The Act further provides that "control" exists if "decisive influence is capable of being exercised with regard to the activities of the enterprise".[53]

[52] Section 54(2)(*b*) of Act 771.

[53] Section 54(3) of Act 771. The control may exist by: ownership of the assets of the enterprise; the right to use all or part of the assets of the enterprise; or the rights or contracts which enable decisive influence to be exercised with regard to the composition, voting or decisions of the enterprise.

SECTION 3: ECONOMIC REGULATORY INSTRUMENTS FOR THE AVIATION SERVICES SECTOR

By the 1990s, Australia, the UK, and the US had deregulated and liberalized their aviation services markets. This section discusses the development of the various economic regulatory instruments for the sector, both internationally and domestically.

Strict Regulations as Priority was on Order Rather Than Competition

As discussed in Sections 1 and 2, all the three jurisdictions surveyed had implemented strict economic regulations to regulate their aviation services sectors. Markets were highly regulated and controlled to ensure stability and reliability of service. Fares, routes, and other activities—such as fleet size and pooling arrangements—were controlled and regulated via the issuance of certificates and permits in the US and licences in Australia and the UK. Financial and managerial strength was viewed as key in maintaining safe and efficient operations. Hence, there were few airlines in the markets.

Competition was secondary to public interest. As mentioned earlier, in the US, certificates and permits were exempted from the application of the US antitrust law and their holders were required to pass the "public convenience and necessity" and public interest tests, respectively. Similarly, consolidation and mergers and acquisitions of airlines were also required to pass the public interest test. Any competition matters were investigated based on fair rather than free competition principles, focusing on unfair and deceptive practices, as well as, public interest.

Changes in the Institutional Arrangements Accompanying Liberalization

The path to sector liberalization and deregulation was evolutionary rather than revolutionary. Apart from repealing old laws, revising existing laws, and introducing new laws, governments had also established relevant institutional arrangements to enforce the revised and new laws and regulations.

In the case of the US, its Civil Aeronautical Board, which was established in 1958 to replace the Civil Aeronautical Authority in 1938, was eventually abolished once the Airline Deregulation Act of 1978 came into force. The focus post-deregulation was the enforcement of the generic antitrust laws—the Sherman Act (1890) and the Clayton Act (1914)—on the sector. The enforcement responsibility is shared between the US DOJ and the US DOT.

For example, the US DOT is responsible for approving antitrust immunities which exempt airlines alliances, cooperation, and JVs. The US DOJ is responsible in investigating any cartel and abuse of dominance cases by aviation-related enterprises. Any consolidation and mergers and acquisitions cases are required to pass the substantially lessening of competition test, as with any other merger cases. Most important, the free competition principle of the generic competition rules applies, in which transactions can be approved but if only they met "significant transportation needs of the community to be served and if there was no reasonably available less anti-competitive alternative" to the transactions.

In the case of the UK, the sector regulator (the UK Civil Aviation Authority) and the national competition authority (the UK Competition and Markets Authority) have concurrent powers to regulate competition matters affecting the UK aviation services market. Meanwhile, cross-border merger cases are investigated by the European Commission Directorate-General for Competition. As for Australia, competition matters for its aviation services sector are the responsibility of its national competition authority, the Australian Competition and Consumer Commission.

Malaysia's Aviation-Related Regulatory Instruments

In keeping with the domestic and international developments for the aviation services sector, as well as, the national policy environment, the GoM has established and enforced a diverse range of regulatory instruments to regulate the aviation sector. Additionally, industry players that are government-owned, publicly listed or both are regulated by additional regulatory instruments as explained later.

Government ownership of assets and companies in the sector is the most intrusive regulatory instruments. As discussed earlier, this remains in place even after the GoM had undertaken the privatization programme in the 1980s. Nevertheless, the GoM had decided to separate the regulatory functions from the asset ownership and operations functions. For example, after 1992, the DCA was responsible for technical, safety, and security regulation for the sector.

Examples of regulatory instruments which are currently in effect to regulate the aviation services sector in Malaysia include the following:

- **Golden share or Special Share**[54]: currently, the GoM has a Special Share in MAHB and MA Sepang which "requires them to obtain the approval of the Government before undertaking certain extraordinary transactions or effecting any significant changes in the operations of the companies in question".[55] The MAHB Prospectus (1999) detailed the following rights of the Special Share:

[54] For detailed discussion, see Box 3.
[55] See above 42. 16.

"The Special Share enables the Government through the Minister of Finance to ensure that certain major decisions affecting the operations of the Enterprise are consistent with Government policies. The Special Share holder which may only be the Government or any representative or person acting on its behalf, is entitled to receive notices of meetings but not to vote at such meetings of the Enterprise. However, the Special Share holder is entitled to attend and speck at such meetings. The Special Share holder has the right to appoint any person, but not more than six at any time to be directors. The Special Share holder has the right to require the Enterprise to redeem the Special Share at part at any time by serving written notice upon the Enterprise and delivering the relevant share certificate. The Special Share holder shall be entitled to repayment of the capital paid-up on the Special Share in priority to any repayment of capital to any other member. The Special Share holder does not have any right to participate in the capital or profits of the Enterprise."[56]

Previously, the GoM had also retained a Special Share in MAS. However, as part of the MAS Recovery Plan, the GoM no longer holds a Special Share in MAB.[57]

- **General legislation:** The aviation services sector is currently regulated the following legislation, amongst others:
  - **Civil Aviation Act 1969 [Act 3]**: provides regulation for technical, safety, and security matters for aircraft, aerodromes and aerodrome facilities, and air navigation services in Malaysia.
  - **Malaysian Aviation Commission Act 2015 [Act 771]:** provides regulation for economic matters including ATRs, setting of charges, competition, slot arrangements, consumer protection, and PSOs for the aviation services market.
  - **Civil Aviation Authority of Malaysia Act 2017 [Act 788]:** administers and enforces provisions detailed in Act 3, as well as, incorporating new provisions which recognize the importance of education, training, and research and development in sector development.

[56] See above 42. 21.
[57] Meeting with KNB, Kuala Lumpur, Malaysia, 15 May 2018.

- **ASAs**[58]**:** ASAs are international treaties entered into by States to govern international air transport and define the commercial rights granted to airlines to fly over and within their territories. So far, Malaysia has entered into 106 ASAs. Additionally, Malaysia, as a bloc with other ASEAN Member States, is currently negotiating the ASEAN-EU CATA. These ASAs include rules on market access and rules to address behind-the-border issues such as competition, subsidies, and consumer protection. For airlines to exercise the ATRs provided under a given ASA, they must meet the nationality requirement provided in the treaty. In turn, the nationality requirements are based on domestic policies—in the case of Malaysia, the current foreign equity shareholding limit in airlines is 49%.
- **FTAs:** FTAs are international regulatory instruments which provide rules to regulate international trade. These agreements are diverse in terms of their scope and depth of obligations for the Parties. Recent FTAs such as the CPTPP incorporate obligations on SOEs as regards subsidies, transparency, and conduct/operations, apart from the usual rules on investments and trade in services, among others. Malaysia is currently a signatory to the CPTPP—together with ten other countries—but it has yet to decide whether to ratify and subsequently enforce the agreement. Should Malaysia decide to do so, then the CPTPP SOE Chapter would apply to aviation-related SOEs such as MAG and MAHB, subject to certain reservations made by the GoM.

Economic Regulatory Instruments in Act 771

Act 771 provides regulation for economic matters for the sector. It contains an array of regulatory instruments to regulate the industry players. It also recognizes the different market structures of the sub-sectors in the aviation services market. As of end-2018, the airports market has a near monopoly structure with MAHB operating 39 of the 42 airports in Malaysia, while the ground handling market is more competitive with 30 companies. Additionally, the domestic airlines market has an oligopolistic structure with four airlines—MAS, AirAsia, Malindo, and Firefly—while the international airlines market has a more competitive structure with 70 airlines.

As such, the different regulatory instruments as contained in Act 771 apply to these different markets:

- **Licences and permits:** Part VI of Act 771 provides MAVCOM with the power to issue licences and permits for companies to operate in the aviation services market in Malaysia. These include licences and permits for air service (scheduled and non-scheduled services for passengers, mail or cargo), as well as, licences for aerodrome operators and ground handlers. These licences and permits provide and set the economic and financial conditions for the industry players to operate.

[58] See above 1.

- **Charges:** Part VI of Act 771 also provides MAVCOM with the power to set charges for aviation services. This may apply to the airports market, which has a near monopoly structure, to ensure that operators do not abuse their dominant position.
- **Competition:** Part VII of Act 771 provides MAVCOM with the power to enforce competition rules for the aviation services market. These rules prohibit anti-competitive agreements, abuse of dominant position, and mergers that substantially lessen competition in the market. The first two prohibitions are ex-post rules while merger control rules are ex-ante. Part VII of Act 771 applies to the aviation services market after MAVCOM commenced operations in March 2016. Between January 2012 and February 2016, the Competition Act 2010 [Act 712], which is under the purview of the Malaysia Competition Commission, applied to the aviation services market in Malaysia.
- **ATRs and slot allocation:** Part VIII of Act 771 provides MAVCOM with the power to administer, allocate, and manage the ATRs procured by the GoM. Part VIII additionally provides MAVCOM the power to supervise and monitor slot allocation including prescribing regulations to set out the principles and procedures for slot allocation. When administering, allocating, and managing the ATRs, MAVCOM considers the effect on consumers, the industry, and public interest, as well as, the effects on competition in the market.
- **PSOs:** Part IX of Act 771 provides MAVCOM with the power to advise the Minister of Transport on PSO policy, as well as, to administer and manage PSO programmes. This includes the RAS programme to provide essential air services to underserved markets in in Sarawak and Sabah.
- **Consumer protection:** Part X of Act 771 provides MAVCOM with the power to protect consumers by prescribing a consumer code for the sector and addressing consumer complaints.

General Economic Regulatory Instruments

Apart from the sector-specific economic regulatory instruments discussed above, enterprises in the sector are also regulated by general economic regulatory instruments that are enforced by other regulators.

Regulating SOEs Including Aviation-Related SOEs

Federal SOEs in Malaysia, which include those in the aviation services sector such as MAG and MAB, are subject to additional economic regulatory instruments.

With the GoM being their shareholders, these SOEs are answerable to the Malaysian Parliament and they may be asked to appear before the Public Accounts Committee on any issues of public interest when required.

The Auditor General's Office also audits SOEs and the outcome of these audits are published in its annual report. Meanwhile, for SOEs that receive government guarantees for their fund-raising exercises, they would be gazetted as a corporate body under the Loans Guarantee (Bodies Corporate) Act 1965 [Act 96]. Act 96 authorizes the GoM to guarantee loans raised by certain bodies corporate and it restricts the borrowing powers of these entities so long as the guarantee is outstanding. In the prospect of default, arrangements must be made to ensure that these entities can fully undertake all its obligations under the guarantee. Except for any confidential information, the Minister of Finance needs to provide details of the guarantee to the Parliament.

Additionally, the MOF's Treasury Circular Letter No.11/1993 provides the policy and guidelines regarding dividend payments by the SOEs to the GoM as a shareholder of these entities. SOEs are required to pay dividend annually to the GoM. The dividend payment must comply with the provisions incorporated in Articles 98 to 107 of the Companies Act 1965 [Act 125].[59]

Regulating SOEs and Non-SOEs Including Those in the Aviation Services Sector

Malaysian companies are incorporated under the Companies Act 2016 [Act 777][60]. These companies may include SOEs even though they are government owned. Act 777 is enforced by the Companies Commission of Malaysia and regulates the constitution of companies, their management and administration, and their financial reporting, among others. Thus, incorporated SOEs, as with other companies, are obligated to file their annual financial returns to the Companies Commission of Malaysia. These records are accessible to the public for a small administrative fee.

Listed aviation-related enterprises such MAHB and AirAsia are also regulated by Bursa Malaysia and the Securities Commission. As with other listed companies, listed SOEs are subject to corporate law and notification requirements. For example, they are subject to the stock exchange requirements of publishing their annual reports and making public information deemed material to investment decisions.

Apart from the hard laws as enforced legislatively, both Bursa Malaysia and Securities Commission have also issued the Corporate Governance Guide and the Malaysian Code on Corporate Governance, respectively, aimed at promoting good governance among businesses in Malaysia. Such soft law approach is to be undertaken and practised on voluntary basis.

[59] Ministry of Finance (1993). Act 125 was replaced by the Companies Act 2016 [Act 777]
[60] Replaces the Company Act 1965 [Act 125].

SECTION 4: MAVCOM'S POSITION AND RECOMMENDATIONS

Ownership liberalization has been an ongoing effort since the 1980s when the GoM introduced the privatization policy, which was subsequently detailed out in the Privatization Masterplan in 1991. Complementing these measures was sector liberalization, which opened various sectors in the economy to new players, thus, introducing competition in the market.

Liberalization in the Malaysian Aviation Services Sector

As discussed in the earlier sections, the Malaysian aviation services sector too has undergone significant liberalization. This was achieved via the following:

- **Negotiating and agreeing for greater ATRs and other liberalization measures**[61]**:** as of 2018, Malaysia has entered into 106 ASAs with other countries. Signatory Parties to ASAs including Malaysia commit to undertake various liberalization measures, which include more ATRs and liberalizing the conditions to operate those ATRs. The latter include determination of capacity and airfares, airlines ownership, and level and conditions of competition such as granting of state aid and subsidies, among others.
- **Promoting both private and foreign ownership:** the aviation services sector became the first of the many strategic sectors that went through the GoM's privatization programme. Section 2 observed that players in the Malaysian aviation services sector have mixed ownership structures. Generally, both private and foreign ownership were allowed for enterprises in the sector. MAS was privatized (but now under full government ownership as MAB) while both AirAsia and Malindo are privately-owned airlines. Additionally, these two airlines, along with the airport operator, MAHB, have foreign ownership via institutional investors, as they are listed on Bursa Malaysia.
- **Introducing and developing competition process in the market:** Malaysia has allowed and encouraged more players to operate in the various segments of the aviation services value chain. For example, current carriers operating in the domestic market include MAB, Firefly, MASwings, AirAsia, and Malindo—in the past, there were also Pelangi Air and Berjaya Air. Additionally, one significant outcome of sector liberalization, both internationally and domestically, is the entry of airlines with different business models.

[61] See above 1.

Meanwhile, in the airport operations market, airport operators currently include MAHB, Senai Airport Terminal Services Sdn. Bhd., Sanzbury Stead Sdn. Bhd., and Tanjung Manis Development Sdn. Bhd. Finally, in the ground handling markets, players include POS Aviation Sdn. Bhd., AeroHandlers Sdn. Bhd., and Brahim's SATS Food Services Sdn. Bhd., among others.

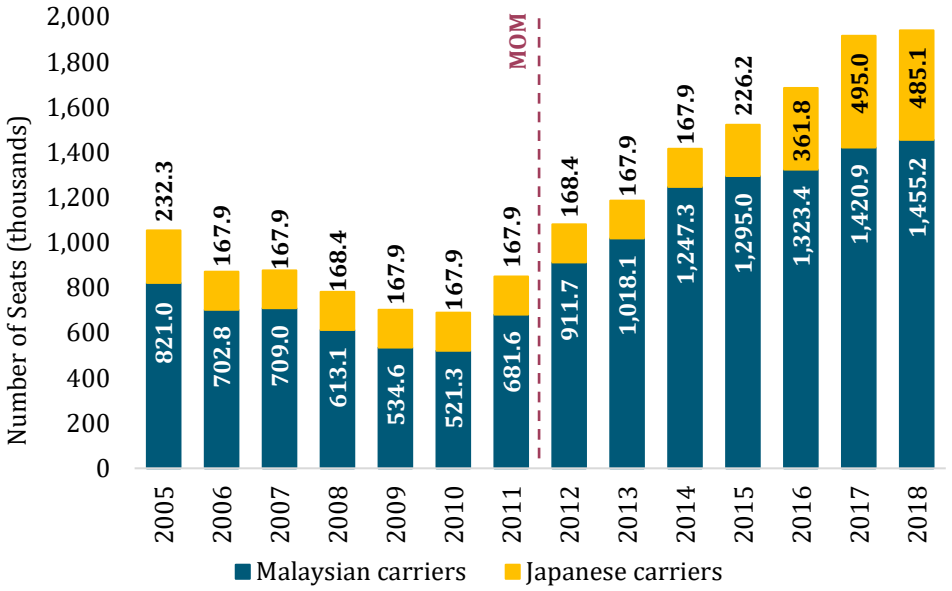
Benefits of Sector Liberalization

Sector liberalization has benefited many parties, including industry players, passengers, and governments:

- **Industry players:** States' commitments to liberalization via ASAs result in the removal of constraints, which previously had served as barriers to entry into the market. As restrictions on routes, capacity, and pricing, among others, are lifted, airlines can optimise their flight networks to meet demand, enhance their service quality by providing direct flights and/or increasing capacity, and compete on pricing. This in turn forces airports to improve their operations as they must now ensure both their hard and soft infrastructure[62] are able to meet the increased demand. Figures 6 to 10 highlight the increase in capacity and reduction in airfares after the enforcement of selected revised ASAs (bilateral Malaysia-Japan and Malaysia-UK ASAs[63]) and a new ASA (ASEAN-China ASA).

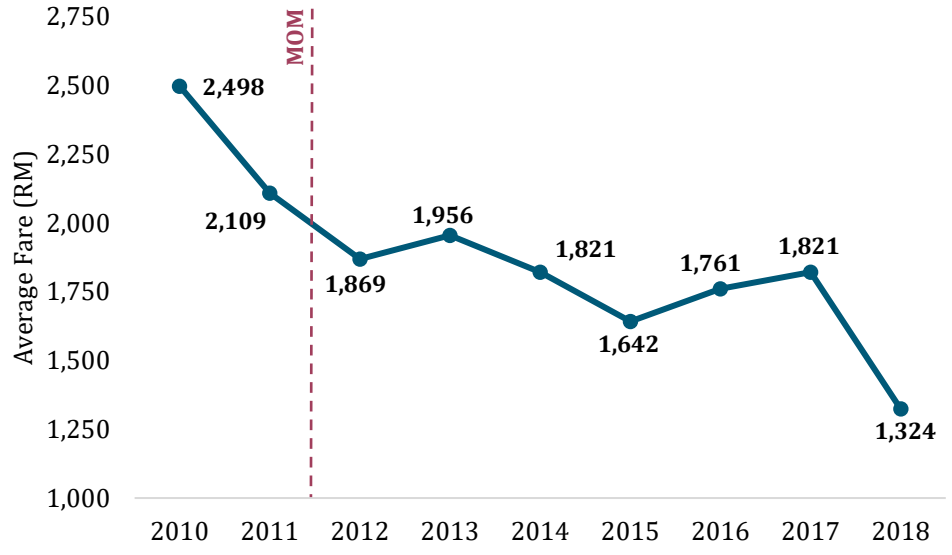
[62] Hard infrastructure includes physical parts of the airports such as buildings, facilities, equipment and machineries. Soft infrastructure includes staffing and information technology systems.
[63] Terms used for these revised ASAs include Minutes of Meeting (MOM) and Agreement of Record (AOR).

Figure 6: Number of Seats Between Malaysia and Japan by Malaysian and Japanese Carriers, 2005 – 2018



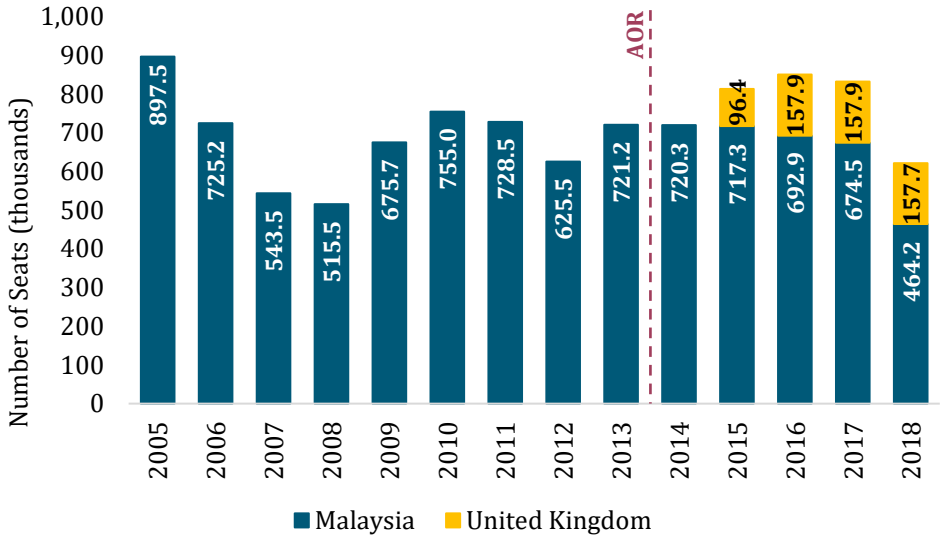
Source: AirportIS
Note: Minutes of Meeting (MOM)

Figure 7: Average Fare Between Malaysia and Japan, 2010 – 2018



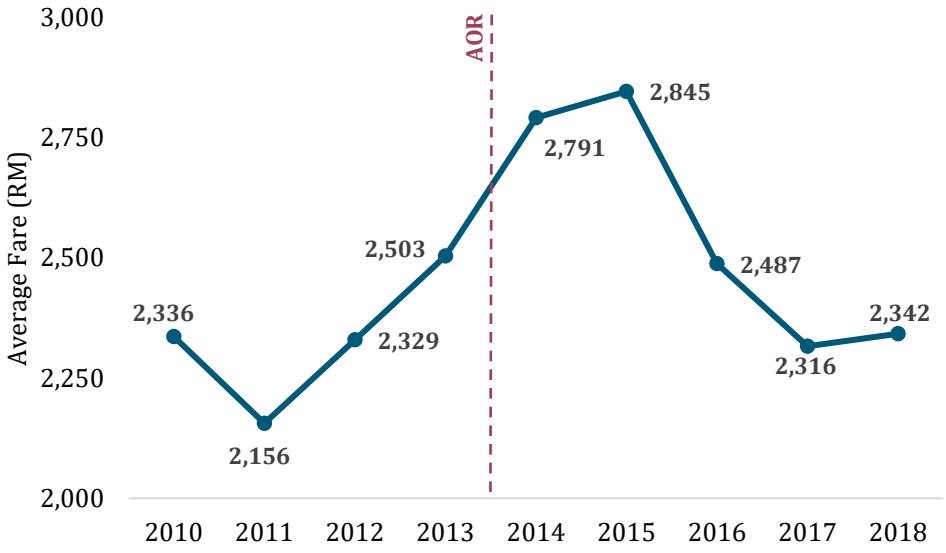
Source: AirportIS
Note: Minutes of Meeting (MOM)

Figure 8: Number of Seats Between Malaysia and the UK by Malaysian and British Carriers, 2005 – 2018



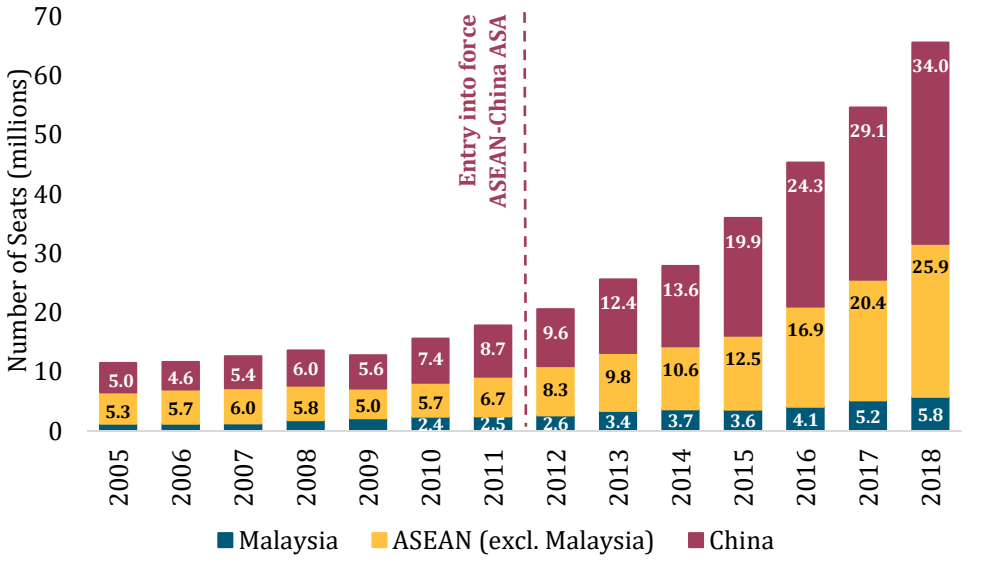
Source: AirportIS
Note: Agreement of Record (AOR)

Figure 9: Average Fare Between Malaysia and the UK, 2010 – 2018



Source: AirportIS
Note: Agreement of Record (AOR)

Figure 10: Number of Seats Between ASEAN Member States and China by Malaysian, ASEAN-based, and Chinese Carriers, 2005 – 2018



Source: AirportIS

The introduction and promotion of competition in the market also force industry players to be more efficient and innovative for them to remain in the market in the long term. These may include operating based on different business models[64] and implementing the latest technology[65] to increase efficiency and productivity. Efficiency and productivity increase the market value of industry players, making them more attractive for investors.

Ownership liberalization allows industry players to access various funding or investment sources in both local and international capital markets. As highlighted in Section 3, ownership liberalization has resulted in equity participation by local and international institutional investors in Malaysia-based industry players. Ownership liberalization also allows for risk diversification as industry players are owned by different types of investors—such as government, retail investors, and institutional investors—and encourages inclusivity of ownership by retail investors in the market.

- **Passengers:** sector liberalization benefits passengers who now enjoy more choices through increased connectivity and lower airfares:
  - Passenger traffic has increased from 65.3mn 2011 to 102.5mn in 2018.
  - As of 2018, Malaysia was connected to 128 international destinations, ranking fourth in ASEAN after Thailand, Singapore, and Indonesia.

[64] Such as focusing on being low cost carriers or as hybrid carriers; as well as, being domestic, regional, or international carriers, among other.
[65] Such as introducing automated check-in processes at airports

- The average airfares for Malaysian carriers had been on the downward trend for both domestic and international airfares from 2011 to 2018. The average domestic airfares decreased from RM245 in 1Q11 to RM215 in 4Q18 while the average international airfares decreased from RM570 to RM467 for the same period.

- **Government:** governments benefit from ownership liberalization as it reduces its fiscal burden as privatized and/or listed industry players have the market as alternative funding sources instead of relying solely on government. Governments can also gain revenue from dividends and tax collected from industry players. Post-liberalization, governments can focus on providing and allocating resources for non-commercial aspects of the sector, such as RAS.

Issues with Sector Liberalization

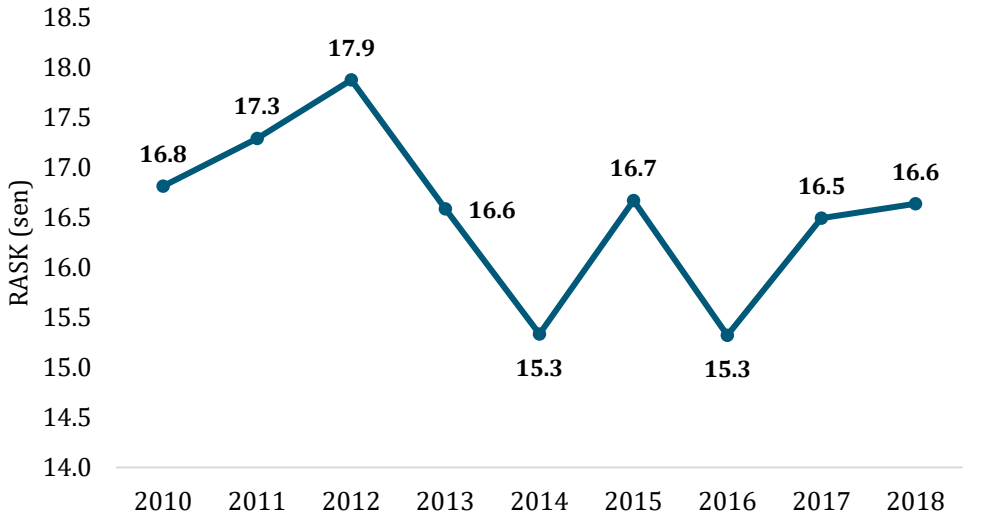
Despite these benefits, sector liberalization is not without its challenges, which include the following:

- **Greater risks and uncertainties:** sector liberalization exposes industry players to market forces in which the laws of demand and supply rule. Efficient and productive players are rewarded—for example, through high share prices and greater demand from consumers—while inefficient and unproductive players are penalized. In the long term, the latter may be forced to exit the market. While industry players can address this by being efficient and productive, they also face market factors beyond their control, thus creating higher risks and uncertainties for revenue planning and management. These include economic events such as the 1997/1998 Asian financial crisis, the 2008 global economic crisis, and the 2008 oil price increase, as well as, non-economic events such as the 11 September 2001 terrorist attack in the US and the global SARS and bird flu outbreaks.

- **Matching capacity with demand:** sector liberalization brings in greater traffic into the market. Airports and their ancillary services need to match their capacity and capabilities to cope with the additional demand. Failure to do so results in congested airports, which could reduce the quality of service for consumers. One way to address this is by managing and allocating slots. However, this is a temporary solution as airport owners and operators would ultimately need to expand their infrastructure to meet increased demand in the long term.

- **Decreasing yields:** Competitive pressure following sector liberalization may result in decreasing yields despite higher traffic volume as industry players attempts to defend their market shares. For instance, average RASK for Malaysian carriers between 2013 and 2018 were lower than the average RASK reported between 2010 and 2012. This coincided with the entry of Malindo Air in 2013, where RASK dropped by 7.2% year-on-year compared to 2012 from 17.9 sen to 16.6 sen (see Figure 11).

Figure 11: Malaysian Carriers' RASK Trend, 2010 – 2018



Source: AirportIS

Supporting Sector Liberalization by Enforcing Regulatory Instruments

Sector liberalization does not mean an unfettered market. Industry players need to operate within the boundaries of law. The GoM has established various regulatory authorities to enforce the relevant regulatory instruments to regulate the market. These include general regulatory authorities such as Bursa Malaysia and Securities Commission, as well as, sector regulators such as CAAM, regulating technical, safety, and security matters, and MAVCOM, regulating economic matters. This highlights the GoM's recognition of the importance of good governance and regulation to support and promote market liberalization to maximize the benefits for consumers and industry players.

MAVCOM's Position

Focusing on the economic aspects and implications of market liberalization of the aviation services sector, MAVCOM has the following position:

- **Addressing policy gaps and keeping policies updated:** both policymakers—MOT and other relevant government Ministries and agencies—and regulators (MAVCOM and CAAM) must work together to continue promoting and facilitating market liberalization. Policymakers must address any policy gaps and keep policies updated to support the regulators' work to regulate and facilitate the development of the sector.
- **Ensuring good governance are practised and promoted:** all relevant stakeholders—including policymakers, regulators, and industry players —must respect and practise good governance in their work as the credibility of the sector's regulatory regime depends on the rules of law being enforced. While sector liberalization entails promoting competition in the market, good governance protects the competition process by discouraging bad behaviour such as anti-competitive conduct, interference in commercial decisions and activities, political intervention, and regulatory capture.
- **Ensuring regulatory instruments are updated:** regulators must keep updated with sector developments, such as market liberalization, which affect how industry players behave in the market. This entails developing, introducing, and establishing new and updated regulatory instruments as traditional regulatory instruments are no longer sufficient and appropriate.
- **Appreciating the pace and consequences of market liberalization:** policymakers and regulators must recognize and appreciate that market liberalization is an evolutionary rather than a revolutionary process, although it may be hastened by technological changes. Policymakers and regulators must also accept that liberalization penalizes inefficient industry players, which may be forced to exit the market in the long term.

MAVCOM's position is reflected in its recommendations and action plans as provided for in the Master Plan:

- **Integrated implementation:** the EMP recognizes that some recommendations involve different stakeholders. Hence, recommendations and action plans must be a collective effort by all relevant stakeholders as working in silos may result in implementation failure.
- **Long-term implementation:** the implementation period of the EMP is up to 2030. Hence, all the relevant stakeholders need to appreciate and recognize that implementing some action plans may take time. There is no quick fix in policymaking and regulatory enforcement.
- **Phased approach:** the EMP recognizes the importance of the phased approach in implementing action plans. This is consistent with the overall evolutionary nature of the market liberalization process.

Addressing Policy Gaps and Keeping Policies Updated

The EMP has identified that there is currently a policy gap in that a National Aviation Policy (NAP) has yet to be established. The GoM needs to address this gap soonest to provide clarity for subsequent work in the EMP and future plans on the airports system in Malaysia. As such:

- The GoM should support the development of an economically sustainable and resilient civil aviation sector that can significantly support Malaysia's evolution into a top destination for global economic activities.
- The GoM should commit to the maintenance of strong institutional arrangements to support a fair and competitive commercial environment of the civil aviation sector.

In view of these, MAVCOM recommends for the NAP to promote and support the sector liberalization, in terms of:

- **Ownership:** increasing private and foreign ownership in the market.
- **Competition:** increasing the number of players in the market.

The NAP should be a "living document" and the GoM should ensure that it remains current by considering the following factors:

- The NAP should recognize the **importance of liberalization sequencing.**
- Regulatory instruments should **keep pace with changing market dynamics.**
- **Conflicts of interests** between policymakers, regulators, asset-owners, operators, and other relevant sector stakeholders **should be avoided**.
- **Competition process**, rather than competitors, **should be protected.**

Ensuring Good Governance is Practised and Promoted

In the context of policymaking and management of national affairs, the United Nations has defined good governance as having

> *"the rules of law, effective institutions, transparency and accountability in the management of public affairs, respect for human rights, and the participation of all citizens in the decisions that affect their lives."*[66]

The spirit of good governance for the public sector is also reflected in the commercial sector.[67] Indeed, the key attributes of good governance are **transparency, accountability,** and **efficiency**.

Good Governance and SOEs

As discussed in Section 2, Malaysian aviation-related enterprises have mixed ownership structures, which include SOEs. While it has been recognised that government ownership in SOEs, including in the aviation services sector, is based on the protection of public interests, the GoM generally and the MOT specifically must be aware of the following points:

- **Perceived preferential treatment by the GoM (policymakers and regulators) for SOEs:** in the context of competition law, any preferential treatment by the Government—such as the provision of subsidies and government guarantees for loans—creates uneven playing field which disadvantages other enterprises in the market.
- **Managing the balance between commercial and non-commercial objectives:** unlike non-SOEs, SOEs may have the additional burden of having to fulfil non-commercial objectives despite having to ensure their profitability. SOEs may have to bear the high costs for aviation services to achieve the social benefits expected by the Government and the public. SOEs must be compensated for undertaking non-commercial activities to ensure they can still undertake their commercial activities as expected by their other (non-government) shareholders.
- **Managing the need to subsidize SOEs which could be inconsistent with international obligations and commitments:** the currently negotiated ASEAN-EU CATA has incorporated comprehensive and deep obligations on competition, including rules on state aid or subsidies. Some of the activities or transactions in the sector may be viewed as subsidies. Thus, the Government may run the risk of being inconsistent with its international obligations and commitments.

[66] United Nations (2000).
[67] See OECD (2015), Bursa Malaysia (2017), and Securities Commission Malaysia (2017).

- **Funding of aviation-related activities and infrastructure by the Government and taxpayers versus by private investors:** the Government may have difficulties in financing aviation-related activities and infrastructure when it also needs to reduce its fiscal deficit and debt. There should be a clear, transparent, and accountable mechanism in funding aviation-related activities and infrastructure.
- **Keeping pace with the latest development of liberalization in the international aviation sector:** historically, flag carriers were owned by their governments, but this has gradually changed with more private investment into airlines. The concept of a flag carrier therefore is becoming increasingly diluted. Indeed, the US has no flag carriers. The GoM also needs to consider the fact that flag carriers do not have to be SOEs or government owned. As mentioned earlier, Germany's flag carrier, Lufthansa is a privately-owned airline and Lufthansa also owns other countries' flag carriers (Austria, Belgium, and Switzerland).

Already, the GoM has established appropriate institutional arrangements (regulators) to regulate the sector, which in turn, are enforcing rules of law that do not discriminate between SOEs and non-SOEs. The GoM may consider doing more by subscribing to international recommended practices on corporate governance of SOEs as provided by the OECD. For example, the OECD recommends for governments to refrain from excessive intervention in SOEs; behave professionally as an owner; ensure SOEs operate with transparency, accountability, and efficiency as practised by non-SOEs; and ensure level playing field for competition between SOEs and non-SOEs.

SOEs must also be mindful that they are no longer part of the Government, but rather independent from the Government when undertaking commercial activities. For the listed SOEs, they must also respect the rights of their non-government shareholders, including any minority shareholders.

Good Governance for all Aviation-Related Stakeholders

Good governance also entails all aviation-related stakeholders—policymakers, regulators, SOEs, and non-SOEs—to behave appropriately and not succumb or resort to political intervention and/or regulatory capture to further their agendas. Again, respect for the rule of law and independent institutional arrangements are key to good governance to ensure that all relevant stakeholders, notably the industry players and consumers, benefit from the liberalization process.

Ensuring Regulatory Instruments are Updated

Section 3 highlighted the diverse range of regulatory instruments currently enforced by the various government Ministries and regulatory authorities in Malaysia. However, some of these instruments may be outdated and need to be revised to ensure efficient and optimal regulation of the sector.

Enforcement of a Sound Aviation-Related Competition Law

Regulators in many jurisdictions are moving away from enforcing the traditional economic regulatory instruments to enforcing competition laws for the aviation services market as it becomes more liberalized. In this regard, Malaysia has been keeping pace with international developments by establishing and enforcing Part VII of Act 771 to regulate competition matters in the sector. Part VII of Act 771 is also based on international best practices, which include the following components:

- Competition principle, which:
  - signals to the relevant stakeholders as to MAVCOM's focus or priority in its competition-related work;
  - guides the enforcement and application of the substantive rules in the law including work on approving exemptions and mergers, as well as, investigating competition cases;
  - provides inputs into economic regulation-work such as approvals for licensing, permits, ATRs, and slot allocation; and
  - highlights how the industry is going to be developed in the future.
- Substantive rules, which include:
  - prohibitions on anti-competitive agreements;
  - prohibitions on abuse of dominant position; and
  - rules on merger control.

However, more work needs to be done in the future to ensure Part VII of Act 771 remains current, both in keeping with industry developments and international regulatory practices. These include:

- **Application of the free competition principle:** the free competition principle focuses on efficiency and maximization of economic welfare. Currently, Part VII of Act 771 is based on the fair competition principle, which focuses on promoting equity or distributive justice. The fair competition principle also places emphasis on the effects of competition on public interests.

- **Application of the competitive neutrality principle:** competitive neutrality principle is a "regulatory framework (i) within which public and private enterprises face the same set of rules and (ii) where no contact with the state brings competitive advantage to any market participant".[68] Currently, Part VII of Act 771 does not incorporate this principle.
- **Application of the subsidies or state aid rules:** state aid rules are enforced in the EU to ensure that any state aid or subsidies provided by States in the EU are targeted to address market failures and avoid distorting competition in the market. Currently, Part VII of Act 771 does not incorporate subsidies or state aid rules.
- **Application of competition rules on common ownership:** common ownership may result in anti-competitive conduct and outcomes such as strengthening the dominant position of enterprises, tacit coordination, market foreclosure, and less incentive to compete among themselves, among others. Currently, while Part VII of Act 771 provides relevant competition rules on common ownership via its prohibitions on anti-competitive agreements, abuse of dominance, and mergers that substantially lessen competition, the accompanying competition-related Guidelines do not discuss in detail the competition-related issues arising from common ownership with minority shareholding and no control.

[68] OECD (2009).

Action Plans

1. Application of competition law based on fair competition principle

Implementation period	Current to medium-term
Stakeholders	MAVCOM

Currently, MAVCOM applies the fair competition principle when applying and enforcing the competition law in Part VII of Act 771. This is currently consistent with the promotion of the application of fair competition principle by the ICAO. However, the ICAO does not provide an official definition of the principle, preferring instead to leave the details and interpretation to its Members.

2. Application of competition law based on free competition principle

Implementation period	Medium- to long-term
Stakeholders	MAVCOM

Competition laws for the aviation services sectors in most jurisdictions are undertaken by their respective competition authorities. These generic competition laws, including Act 712, are mostly based on the free competition principle.

MAVCOM will close this gap by moving to applying the free competition principle on a phased basis, in the medium- to long-term. It must be noted that the adoption of free competition principle will affect the application and enforcement of competition law in Part VII of Act 771 vis-à-vis the overall function of MAVCOM—that is, MAVCOM may need to have a narrower approach when undertaking its competition work, prioritizing free market over public interest, for instance.

3. Incorporation of competitive neutrality principle and state aid rules

Implementation period	Medium- to long-term
Stakeholders	MAVCOM

MAVCOM notes that already certain ASAs and FTAs have incorporated the competitive neutrality principle and subsidies/state aid rules to reflect the existence of such principle and rules in the competition laws of certain jurisdictions. As observed earlier, Part VII of Act 771 currently does not incorporate the competition neutrality principle and enforce state aid rules. MAVCOM will undertake a study to review Part VII of Act 771 and to recommend the appropriateness of incorporating such principle and/or rules in Part VII of Act 771 in the future.

4. Revision of competition-related Guidelines to ensure relevance

Implementation period	Medium- to long-term
Stakeholders	MAVCOM

MAVCOM will undertake periodic review of its competition-related Guidelines to ascertain relevance and the need for revision, if necessary. This may include vertical common ownership and common ownership with minority shareholdings and/or control.

Reviewing Government's Golden Shares in the Aviation Sector

The earlier sections observed that the GoM currently has a golden share in its airport operators—MAHB and MA Sepang. This was put in place post-privatization as the GoM wanted to ensure that the national interest is protected and the SOEs' strategies and activities are aligned with national policies. Admittedly, when the golden share was introduced, the regulatory environment in Malaysia was still underdeveloped. However, the golden share is now an outdated regulatory instrument as its role and functions are superseded by the implementation and enforcement of newer and more comprehensive regulatory instruments such as those contained in Act 771. Additionally, golden shares are also considered to be anti-competitive (recall discussion in Box 3). Finally, having a golden share imposes additional regulatory burden on SOEs, including aviation-related SOEs, and making them unattractive to potential investors.

Action Plan

1. Abolishing the golden share in airport operators

Implementation period	Short-term
Stakeholders	MOF and airport operators

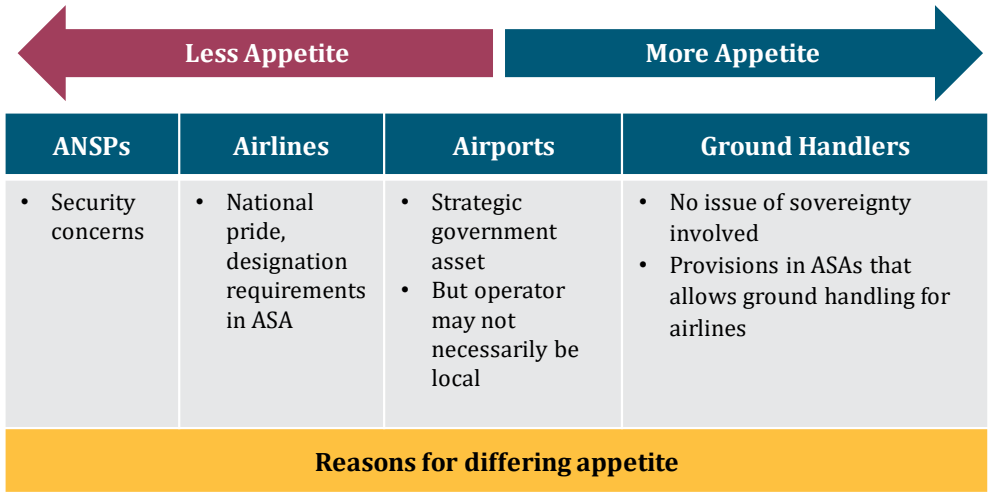
The GoM no longer holds a golden share in the flag carrier following its restructuring programme. As such, the GoM should be able to abolish its golden shares in the airport operators as the role and functions of golden shares are superseded by the implementation and enforcement of newer regulatory instruments as contained in Act 771. Furthermore, abolishing the golden shares in the airport operators may make the enterprises more attractive to foreign investors who are considering taking up larger equity stakes in the enterprise. A potential negative is the impact on fund-raising activities as the golden share may accord MAHB with sovereign ratings, which may not be available if it is abolished.

Appreciating the Pace and Consequences of Liberalization

The GoM should continue with its phased approach in expanding the ownership liberalization policy for the sector but at the same time, respect the industry players' readiness to liberalize at an earlier timeline. Ownership liberalization can be undertaken by encouraging and allowing for local private ownership (privatization) and allowing for foreign ownership in local assets and service providers. In particular, the phased approach will consider the different levels of appetite for liberalization of the key sub-sectors in the aviation services market.

Despite the sector liberalization having been in progress since the 1980s, the GoM still has different levels of appetite for liberalization of the key sub-sectors in the aviation services markets, as illustrated in Figure 12. If the appetite for liberalization could be illustrated in a spectrum, with its far left representing no or the least appetite for liberalization and its far right representing the highest level of appetite for liberalization, then the ANSP sub-sector would be situated at the far left while the ground-handlers sub-sector is at the far right of the spectrum.

Figure 12: Differing Appetite for Liberalization in the Aviation Industry



Source: MAVCOM

Promotion of Ownership Liberalization Policy for Airports

The GoM seems to have a neutral view for the ownership liberalization of airports in Malaysia. This may be due to the already relatively liberalized structure of airports in Malaysia via the PPP arrangements (concession agreements). There are various permutations and combinations that the Government may consider in liberalizing the ownership structure and form for the airports. Already the GoM has allowed private local service operator (Senai Airport Terminal Services Sdn. Bhd.) to own and operate JHB.

Action Plan

1. Phased approach to liberalize ownership/equity policy of airports

Implementation period	Medium- to long-term
Stakeholders	MOF, MOT, and MAVCOM

The ownership liberalization of airports could be extended in the future by breaking up the existing airports network into regional airport networks, each operated by different service operators, including private local or even foreign operators.[69] However, all the relevant stakeholders need to consider the various factors and challenges in airport ownership liberalization including the need for distinction between commercial and non-commercial airports; profitable and non-profitable airports; and implications on the current negotiations for the operating agreement between the GoM and MAHB, among others.

Promotion of Ownership Liberalization Policy for Ground-handlers

The GoM is more open for the ground-handling sub-sector to be more liberalized in terms of ownership, that is, both for private ownership by local investors, as well as, greater foreign equity shares. This is evidenced by the comparatively large number of ground-handlers operating in the Malaysian airports and some being co-owned by foreign enterprises (such as Brahim's SATS Food Services Sdn Bhd and SATS Ground Team Red Holdings Sdn Bhd). Indeed, ground-handlers are the most ready and open to liberalization.

Action Plan

1. Phased approach to liberalize ownership/equity policy of ground-handlers

Implementation period	Medium- to long-term
Stakeholders	MOF, MOT, and MAVCOM

While there are already privately-owned ground-handlers, the GoM may want to consider allowing for majority and up to 100% foreign-owned ground-handlers to operate in Malaysian airports. International experience highlights that foreign-owned ground-handlers may have better funding capacity and technological capabilities.

[69] For more details, see MAVCOM (2019).

Promotion of Ownership Liberalization Policy for Airlines

Currently, the GoM is comparatively reluctant to the airlines being more liberalized in terms of ownership—that is, the flag carrier being owned by a private investor as was the situation in the past or wholly-/majority-owned by foreign investors as done by Lufthansa and Etihad Airways.

Admittedly, the discussion on ownership liberalization for airlines is more complex due to its interlinkages with the GoM's commitments at the international level by being a Party to the ICAO legal instruments and ASAs, either bilaterally with another State or regionally with a group of States.[70] For example, the exercise of ATRs under the ASAs may only be enjoyed by airlines that are considered nationals of Parties to the ASAs. In turn, the airline nationality requirements in these agreements may be based on different approaches:

- Substantial ownership and effective control
- Principal place of business
- Effective regulatory control

Malaysia adopts the substantial ownership and effective control requirements for the establishment and designation of airlines. Under Act 771, MAVCOM has the power to issue an air service licence to an airline that is established in Malaysia to undertake scheduled air services.[71] It also has the power to prescribe the requirements for the issuance of such licence.[72]

In Malaysia, amongst the criteria considered in assessing air service licence applications are:

- whether the airline is a company incorporated in Malaysia
- whether the airline is directly or indirectly under the control of a Malaysian person
- the ownership structure of the airline

A person is considered as having control over a company if such person has an interest of more than 50% of the share in the company[73], and any of the following:

- Power to elect, appoint, remove or prevent from election a majority of the directors of the company
- Power to make business or administrative decisions of the company
- Power to direct or instruct the directors, chief executive officer or senior officers of the company, formally or informally

The existence of control may also be inferred from any other relevant factors on a case-by-case basis.

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[70] For more details, see above 1.

[71] Section 35 of Act 771. Applicants are also required to apply to the CAAM for an Air Operator's Certificate for their proposed operations. An air service licence will only be issued to an applicant who holds a valid Air Operator's Certificate.

[72] Section 39 of Act 771.

[73] "Shares" means issued ordinary share other than preference share which confers the holder the right to attend, participant and speak at a meeting; the right to vote; the right to an equal share in dividends authorized by the board or the distribution of the surplus assets of the company.

At the moment, in contrast to the ASEAN Member States' active liberalization of ATRs in the ASEAN context, there appears to be a general reluctance to liberalize in terms of airline nationality.

The substantial ownership and effective control requirements still prevail in other ASEAN Member States. Indeed, the issue of ownership and control of airlines is identified as one of the economic elements under the ASEAN Single Aviation Market. However, at present, the intra-ASEAN liberalization of the ownership and control requirements or the establishment of ASEAN community carriers do not seem to be of priority to ASEAN Member States as it is neither identified nor mentioned in the ASEAN Transport Strategic Plan 2016 – 2025.

Regardless, ASEAN ASAs such as the MAAS and the MAFLPAS provide for the possibility of establishing an ASEAN community carrier based on the substantial ownership and effective control by one or more ASEAN Member States and/or its nationals. However, this possibility is only exercisable subject to the acceptance by the authorizing Party.[74]

In addition, the MAAS, the MAFLPAS, and the ASEAN-China ASA provide for the possibility of designating a national airline based on the principal place of business and the effective regulatory control requirements. However, such designation is also subject to the acceptance by the other Party.

Action Plans

1. Phased approach to liberalize ownership/equity policy of airlines

Implementation period	Medium- to long-term
Stakeholders	MOF, MOT, and MAVCOM

Plans to re-list Malaysia's flag carrier (MAB) may be the first step towards a more open environment in the future. Already, other countries are considering a more relaxed approach towards foreign equity shareholdings for their airlines sector but still within the boundaries of sovereignty principle for airspace.

In charting its future policies regarding airline nationality requirement, Malaysia should deliberate on whether there is a need to liberalize its airline nationality requirement in order to further develop its aviation industry. The factors that should be considered include the availability of domestic capital, as well as, the effects of such liberalization on the market, industry, and consumers, taking into account the experiences of other countries.

[74] Illustration: Malaysia designates Airline A, which is established in its territory, and substantially-owned and effectively-controlled by nationals of ASEAN States. If Airline A wishes to operate the agreed services under the MAAS or MAFLPAS on routes between Malaysia and Singapore, Singapore has the discretion to accept the designation and to authorize the airline, or to refuse the authorization of the airline. On the other hand, if Airline A is established in Malaysia, owned and controlled by Malaysian nationals, and designated by Malaysia, Singapore has the obligation to authorize Airline A under the MAAS or MAFLPAS (subject to the other conditions under Article 3(2)(b) and (c) of the agreement).

However, a number of States have liberalized the nationality requirement for their airlines by applying the principal place of business principle, the regulatory control requirement, and/or the ownership and control by a national of any Party within a group of States (such as the EU community carrier). Based on the ICAO, there are 316 and 142 bilateral ASAs that recognised airline nationality based on the principal place of business and community interest, respectively.[75]

Given that the airline nationality requirement is governed at both the domestic and international levels, any liberalization would necessarily entail changes to the States' domestic laws, as well as, amendments to the existing ASAs. Unilateral liberalization of the airline nationality requirement by a State might have a minimal impact. A foreign-owned airline established in a State would be limited to domestic operations, since other States may withhold their authorization for that airline to provide international air services under the ASAs that contained the ownership and control requirements.

2. Championing the liberalization of cross-border ownership rules for airlines in ASEAN

Implementation period	Long-term
Stakeholders	MOT, MAVCOM, and industry players

This recommendation recognizes the growth and potential of an airline to become a community carrier in the region as done in Europe as part of its single market integration generally and single aviation market specifically. With the adoption of the EU community air carrier, EU airlines are required to be owned and effectively controlled by EU Member States and/or their nationals.[76] Any airline that meets such ownership and control requirement will then be licensed by the EU Member State in which it has its registered office and principal place of business.[77] An EU community carrier has the right to exercise unfettered ATRs on any route within the EU. These measures effectively created a single intra-EU aviation market akin to a singular State.

[75] Out of 2,913 ASAs. ICAO World Air Services Agreements database. Available at https://data.icao.int/wasa

[76] The liberalization of the European aviation market also encompassed the following measures: the removal of restrictions on market entry, capacity, frequency, and pricing in the airline industry; greater emphasis in competition law to safeguard against anti-competitive behaviours; stricter implementation of the state aid policy to the industry; the liberalization of the ground-handling sector; the establishment of common rules on slot allocation at congested airports to facilitate competition; and the establishment of a code of conduct for CRSs.

[77] Subject to such airline meeting the applicable financial and safety requirements as well. The conditions for an EU community carrier are currently governed by Article 4 of the Regulation (EC) No. 1008/2008 on air services.

An ASEAN community carrier could be any airline that is owned and controlled by ASEAN nationals, or any airline with its principal place of business within ASEAN. This would entail negotiating for broader and more liberal intra-ASEAN ownership provisions in ASEAN regulatory instruments, as well as, ASEAN's agreements with its Dialogue Partners. It must be noted that currently, the appetite of the ASEAN Member States is low for such a model but in the long term this could change as ASEAN faces competition from non-ASEAN airlines.

While this facilitates and promotes competition and investment in the airlines industry, the downside is the establishment of FoC carriers, modelled after the shipping ownership in the maritime industry. The FoC carrier is defined as one "established in a country other than the home country of its majority owner". An example of an FoC carrier is NAI, which is based in Ireland but has been granted approval to fly to the US. The unintended consequences include avoidance of stricter regulations in the home markets, which may affect the employment structure of the industry and reduced quality of safety. For example, in the case of NAI, it was claimed that NAI is based in Ireland instead of Norway to take advantage of the less stringent Irish employment law. Also, there could be similar risks of such FoC carriers to forum-shop to be based in a jurisdiction with lax security rules and regulations.

Finally, airlines have been able to technically circumvent ownership restrictions by participating in alliances, JVs, and code sharing with other airlines. For example, MAB is currently a member of the oneworld alliance.

These issues highlight the need for review of the current ownership policy, not just in Malaysia, but also in ASEAN. While this is a long-term action plan, work could commence in the short- to medium-term to assess the costs and benefits of this recommendation. For example, championing the liberalization of cross-border ownership rules for airlines in ASEAN may come at the expense of the growth and support for flag carriers. Also, while allowing for cabotage may be positive for consumers who benefit from increased connectivity and potentially lower prices, it could have adverse implications on domestic airlines, which would face greater competition in the market.

Promotion of Ownership Liberalization Policy for ANSP

As compared to other sub-sectors in the value chain, the GoM is least open to consider liberalizing ANSP ownership potentially due to security concerns. As mentioned earlier, the ANSP in Malaysia currently comes under the purview of CAAM. Box 5 observed that the Malaysian experience is not an anomaly as there are only a few jurisdictions that have liberalized and privatized their ANSPs, notably Canada and the UK.

Action Plan

1. Phased approach to liberalize ownership/equity policy of ANSP

Implementation period	Medium- to long-term
Stakeholders	MOF, MOT, CAAM, and MAVCOM

Longer term, the GoM may consider and commence work to privatize the ANSP to address the resource constraints that it is facing to develop this sub-sector.

SECTION 5: CONCLUSION

The aviation services sector is arguably the first strategic sector that has undergone liberalization, both in terms of the ownership liberalization and introduction of competition, at international, regional, and national levels. Its liberalization has been undertaken on a phased basis. However, this process has hastened due to significant technological changes.

The GoM must recognize and appreciate that sector liberalization penalizes industry players that are not efficient and they may be forced to exit the market in the long term.

Policymakers and regulators must work together to promote and facilitate sector liberalization. Policymakers need to address policy gaps and keep policies updated to support the work of regulators in regulating and facilitating the developing of the sector.

Regulators, including MAVCOM, must appreciate how sector liberalization could affect how industry players are regulated. Thus, regulatory instruments must be updated as traditional regulatory instruments are no longer sufficient and appropriate to regulate the market.

All relevant stakeholders must practise good governance in whatever that they do to ensure the benefits of sector liberalization are maximized. Indeed, with liberalization and the presence of private players, the regulatory regime and the organizational capabilities to implement must exist and be free from political intervention.

Finally, it is important that the issues and challenges of sector liberalization be addressed on a timely basis to benefit and increase the welfare of both consumers and industry players in and for the long term.

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