

Consultation Paper 3.4

Approaches to the Corporatisation of Airports Management

Executive Summary

The management of airports should be outside central government. Initially airports should be managed as a whole business to enable revenues to be used where they will create the greatest benefit to the Afghan economy. This implies, at least initially, a single, centrally managed, corporate entity as opposed to an institutional structure that has a number of corporate entities based in the regions. The possibility of devolution into five companies might be considered when the economy is more fully recovered. The single company should remain in place a minimum of five years.

Regional interests should be properly represented at Board of Directors level. They should be involved in all decisions that affect regional investment plans and strategies, as well as implementation issues such as capital works programmes.

As many as possible of the functions that are related to airport operation should be devolved to the regional airport for management.

The Board should follow normal company structure. It should include one member of central government, one member from each region, four members with expertise in aviation, business and financial management and law, together with the President of the company and the deputy President for finance.

The relationship between the company and the government should give the government control over substantive financial issues but give the company the commercial independence necessary to operate a successful business.

There will be a number of airports which will not be commercial and which government will have to pay for under a Community Service Obligation (CSO). These airports should be accounted for separately from the accounts of airports considered commercially viable.

There should be a contract between the company and the government which should elaborate these principles and for which an outline is suggested in Annex 2 to the Paper. It will be important in the contract to provide for the government to have the power to designate the status of airports e.g. international, regional, sub-regional, but in making the designations the government should take into account the views of the airport company.

Price regulation of airports is not recommended but the government should have the power to intervene in the event of an abuse of a monopoly position.

The airport company should be charged with the responsibility for developing an airports' investment strategy.

To begin the process of creating the airports company a Project Management Unit should be attached to MCAT to build the concept proposed and identify the process of change that is required. It should be responsible to the deputy Minister. In particular it should:

- identify and value the assets involved.
- Prepare Articles of Incorporation.
- Work out a basic management structure.
- Appoint directors, identify potential staff.
- Design the administrative (including the accounting) system.

Thereafter it should be attached to the company, once it is created, to assist in the implementation of its plans.

The PMU will require technical assistance. The expertise required is set out in the paper. It is estimated to amount to 36 man months at a cost of about USD 1 million.

Recommendations:

It is recommended that one airport company to manage, in principle, all Afghanistan's airports for a minimum period of five years be established.

Actions:

A Project Management Unit in the Reform and Restructuring Office (see Consultation Paper 3.7) to implement the above should be established.

MCAT should apply for funding and expertise at a cost of about USD 1 million.

Introduction

The TSR Background Document recommends that a corporate entity should be created to own and operate the airports, its shares to be at least initially held by the government. The corporate entity should be managed by people with commercial technical and operational expertise and the government powers to intervene should be limited to a broad investment and financial control or to the giving of directions in the public interest. As much responsibility as is feasible should be devolved to the regions.

It is further envisaged that, depending on the policy towards decentralisation in general adopted by the government, consideration should be given after a number of years of operation of the corporate entity to a devolution of groups of airports to corporate entities based on the five major centres. Kabul, Herat, Kandahar, Mazar i Sharif and Kunduz.

The purpose of this paper is to sketch out what might be the shape of an initial corporate entity structure.

Institutional Structure and the Government Objective

To establish a corporate entity to manage the Airports of Afghanistan there are five issues to consider:

- **The management of airports should be outside central government.** Independence, autonomy, accountability and a focus on efficiency are all criteria that are considered to be essential for the management of infrastructure and service delivery. A government department is generally focussed on policy and strategy and providing advice to government. Infrastructure management and service delivery are secondary matters to this prime purpose and there are many instances where management by a government department has led to less than desirable achievements for infrastructure management and service delivery.

Airports are enterprises which are essentially commercial in nature and should be free from the constraints that are normally applied in central government. Those constraints are:

- Non-commercial decision making;
 - Lack of ability to meet the demands of the market;
 - Lack of commercial financial and balance sheet reporting;
 - Inability to identify direct unit costs of operation;
 - Rigid pay structures.
- **The investment of capital requires commercial expertise.** Following on from item (a) the investment needed in the Afghanistan airport infrastructure is substantial and a corporate entity, with appropriate commercial skills and experience, will be able to apply the capital that is needed in a commercial way.
 - **Revenues ought to be applied to maximise economic benefit.** Initially, airports should be managed as a whole business to enable revenues to be used where they will create the greatest benefit to the Afghanistan economy. The management of airports in this structure will enable a capital investment strategy that includes a cross subsidy for airports that do

not generate sufficient income to fund capital or maintenance but are nonetheless important in the context of providing transport services. One company can also take into account national priorities as opposed to an institutional structure that has five corporate entities (one for each major airport).

- **Regional interests need to be properly represented.** Airports are and should be recognised as important centres of commercial activities in the areas where they are situated. The proposed corporate structure should ensure that regional interests are properly represented at Board of Directors level and as many of the functions as possible that are related to airport operation should be devolved to the regional airports for management.

In developing this institutional approach, small regional airports have not been separated out, but rather remain included in the overall management structure because they are important in the short to medium term as the road system is not sufficiently viable to support all the social and economic need of the country. As the economy develops, categories of airports may well change and it is important to make the change easily.

Structure of the Central Company

Regional Participation

It is vital that Regions should not feel that they are dictated to by a central Airports Management Company that is based in Kabul. There are two critical policy decisions that are needed to ensure that regions are involved, namely :

- There should be a devolving of functions to regions that allows the implementation of policy and programs at a regional level. Regional management is far better placed to manage the implementation issues based on local conditions.
- The five major regions - Kabul, Kandahar, Herat, Mazar i Sharif and Kunduz - should be represented on the Board of Directors. Regions must be involved at the central level on decisions that are required to be taken at a central level that affect regional investment plans and strategies as well as implementation issues such as capital works program implementation (Annex 1 sets out the issues that should be managed at a Regional level).

To complement that approach in the future, the TSR view is that it would be desirable to facilitate Regions taking shareholdings in the Airport Company. At some stage it would be reasonable to provide for the injection of capital into assets and that capital is not derived from Central Government. The opportunity should be afforded to the Regions to provide that capital input for infrastructure that is vital to their regional economy.

Board Structure

The structure of the Board should be a normal company structure, similar to the approach taken to the corporate structure of Ariana (See Policy Paper 3.3). In line with the suggestions made for the Board of Directors for Ariana, the Board of the Airport Company should comprise :

- One member of Central Government.

- One member from each major region.
- Up to four members that have expertise in aviation, business management, financial management and law.
- The President of the Company and the Deputy President of Finance.

The Chairman should be selected from one of the four experts.

Management Committee

Consideration should also be given to establishing a Management Committee that comprises the President and Vice Presidents of the Company. It is a normal structure within companies to adopt an institutional approach that separates the day-to-day management from the role of the Board of Directors which is to oversee the general direction and major policies and strategies of a company. The Management Committee would supervise the day to day running of the company and control of management strategies set by the Board, including developing performance measures and monitoring performance.

Management Structure

The Management structure should be organised on a 'vertical basis'. The major positions within the company should reflect normal company practice and include the President, Line Deputy Presidents that might include a Deputy President - Finance & Investment, a Deputy President - Regional Operations, and a Deputy President - Administration (Personnel, Legal). Other technical Vice Presidencies to manage technical issues will also need to be established to manage safety and compliance issues.

The Deputy President - Regional Operations would have a service delivery function with supporting regional management positions at the regional airports to deliver and manage capital programs and services.

Company Articles

Company Articles will need to be developed to reflect the corporate structure that is finally approved. Those Articles should be similar in approach to the Ariana Company Articles.

Relations Between Government and Company

It is desirable that the powers of the Government in relation to the Airport Company be precisely defined (in much the same way as Ariana). The Articles of Incorporation will be able to prescribe this relationship only to a certain point and then it becomes necessary to develop a set of protocols in a separate document that establish the relationship with and the powers of Government.

This paper strongly recommends that the relationship needs to be at 'arms length' in order to prevent (and be seen to prevent) conflicts of interest occurring and to provide the Airport Company with sufficient commercial independence to operate successfully. In keeping with the recommendation made in relation to Ariana, it is appropriate that a 'contract' be executed between the Government and the Airport Company where the relationship is specified. That

contract is transparent and is akin to standard documentation between a parent company and a subsidiary. It will allow for the performance of the Airport Company to be monitored.

The objectives of the 'contract' would be to:

- Provide the Airport Company with sufficient commercial independence to operate a successful business - matters of substance would require government approval.
- Clearly set out the relationship between the Government and the Airport Company.
- Specify the reporting arrangements between the Airport Company and the Government.
- Require a separation of the accounts of "commercial" airports and airports paid for by government under a Community Service Obligation (CSO).
- Specify the substantive matters that require Government approval.
- Provide the Government with an emergency power to intervene at 'arms length' in the management of the Airport Company.

This contract would be sufficient to provide Government with control over the Company operations generally, but at 'arms length' to ensure a properly functioning commercial operation.

The importance of separating the costs of CSO's (as set out in paragraph (d)) will show the actual costs to government. In the event of privatisation, it will be important to show the commercial areas of revenue and thus potential value of the assets. In relation to CSO's it will provide government knowledge in purchasing CSO's from the private sector and the level of service it can expect for those funds.

In addition, it will be important in the contract to provide for the government to have the power to designate the status of airports - for example, international, regional, sub-regional. In making decisions about airport classifications, the government would take into account the views/recommendations of the Airport Company.

In keeping with the recommendations of the Background Document, price regulation of airport activity is not recommended. It will only add to the cost of administration of airports and Government. But in a monopoly situation as the Airport Company is, where there may be an abuse of market power, there should be a reserve power to Government to impose price controls if in its view the airport charges constituted an abuse of its monopoly position and it could be shown that the Airport Company was inhibiting the redevelopment of the country.

A draft contract outline is set out in the Annex 2

Airport Designation

As mentioned in above, Airport designation should be a role exclusive to the Government at this stage. The role of airport designation - international and 'others' should to be undertaken with a national perspective and policy on economic development and regionalisation issues. The Government should however act on the recommendation of the Airport Company and the view of the airlines that are providing international services to Afghanistan and their 'hubbing' strategy. The Government will also need to include its customs and immigration needs in making decisions about airport designations.

It is expected that designations will be flexible to deal with changing circumstances brought about by economic and development changes, especially changes in the road network and land transport services that provide greater and cheaper access to and within the country.

Investment Strategy

The Airport Company would be charged with responsibility for developing an airports investment strategy. Normally that is done after master plans have been prepared for the relevant airport.

The TSR has undertaken a physical review of all airports and has costed the required capital outlay to bring the various airports up to ICAO standards. Those costs do not include Kabul or Kandahar. The airport at Kabul has had substantial capital invested and is still operating in part as a military airport and Kandahar is predominately a military airport so neither have been included in the capital needs assessment at this stage. Both have been the subject of a detailed review by the Joint Donor Mission. This review is to be found in a separate paper.

The expenditure for the work identified is USD\$ 22.5 million spread over six years. Details of the capital expenditure by Airport are set out in the Overview document, and its Annex.

Community Service Obligations

In the initial phase of the Airport Company and indeed until some normalcy is reached in the transport sector, Community Service Obligations (CSO) will be a major part of the Airport Company's operations. CSO's comprise government undertaking services that are for the good of the community and particularly relate to access issues - health, to markets etc. Delivering CSO's is generally not profitable and so not in the commercial interests of the Airport Company, but rather in the national interest.

CSO's are normally funded by government (whether the costs are capital expenditure or ongoing service delivery costs) and so the Airport Company will need to work closely with Donors and the Government. The Company should however be required to :

- Manage the airports efficiently so that the cost of CSO's are kept to a reasonable level; and
- Account separately for CSO works and services in order to be transparent in the real costs to it and government.

Implementation Steps

The exact nature of the assistance needed to implement the recommendations in this Paper will be determined after government decisions have been made on the restructuring of airports management.

The main step is to implement a Project Management Unit (PMU) in the Reform and Restructuring Office of MCAT (see Consultation Paper 3.7). The role of the PMU essentially

would be to build the concept outlined in this paper and identify the process of change that is required. The PMU should be able to create the Company within 6 months and have achieved:

- The identification of the assets (and their value) to be transferred to the Airport Company.
- The preparation and approval of the Articles of Incorporation.
- The basic management structure.
- The appointment of the Board of Directors.
- Identification of the staff to transfer to the Company.
- The design of the administrative systems including the accounting systems.

Once those tasks have been completed, the Company should be operational and the PMU would then be attached to the Company for a further 6 months to assist in implementing the Company structure. The implementation would see the following outcomes within those six months :

- The approved classification of the airports.
- The contract with Government executed.
- The administrative and financial systems in place.
- The appointment of people to positions.
- The first Business Plan developed and approved by the Board and Government.

The composition of the technical assistance PMU is envisaged as follows :

- An Airports Manager who would be experienced in finance, management decision systems, organisational structures, business planning (framework). Required for 12 months.
- Financial Management Expert (international) experienced in financial management systems. Required for 6 months.
- Lawyer (Local or International) to undertake the preparation of the Articles as well as leasing of concessions. Required for 6 months.
- An Airports Technical Expert (international) experienced in buildings management and airside landside ICAO requirements. Required for 12 months.

Legislation will be required to provide for the transfer of assets from Government to the Airport Company. The legislation is required to make the following issues clear :

- The effect of the asset transfer is for the Airport Company to hold the assets on behalf of the State. The transfer will occur without consideration so the Airport Company is not saddled with debt immediately on its creation.
- The asset transfer may happen without a valuation but a valuation must take place within 12 months of the establishment of the Airport Company.

A total of 40 man months is required and the cost of implementing the PMU approach will be approximately USD 1 million.

Recommendations

It is recommended that one airport company to manage, in principle, all Afghanistan's airports for a minimum period of five years be established.

Actions

A Project Management Unit in the Reform and Restructuring Office (see Consultation Paper 3.7) to implement the above should be established.

MCAT should apply for funding and expertise at a cost of about USD 1 million.

Annex 1 – Regional Functions

<i>Task</i>	<i>Management by</i>	
	<i>Central HQ</i>	<i>Local Airport</i>
Management of airport system	HQ	
Management of terminal and other buildings		Local Airport
Cleaning of terminal and other buildings		Contractor
Flight service – e.g. weather, runway condition and preferred landing direction (if provided)		Local Airport or airline agent
Check in, ticketing, cargo handling and passenger service		Airline agent
Baggage handling		Airline agent or Local Airport
Rescue fire service (if provided)		Local Airport or contractor
Maintenance of pavements (runway, taxiways, apron), remove stones and foreign objects from pavements, pavement markings, drains, etc. Carry out repairs, repaint markings as required.		Airport maintenance staff or contractor
Snow clearing		Airport maintenance staff or contractor
Maintenance of runway strip (cut grass, remove stones, keep drainage system operational, strip markers, wind indicators, unserviceability markings, etc)		Airport maintenance staff or contractor
Maintenance of obstacle limitation surfaces (approach and takeoff fans, transitional surfaces)		Airport maintenance staff or contractor
Maintenance of buildings, roads, car parks, fences, street lights		Airport maintenance staff or contractor
Maintenance of airport lighting including apron floodlights (if provided)		Airport maintenance staff or contractor
Maintenance of communications equipment (if provided)		Contractor
Maintenance of standby generator and electrical reticulation system		Contractor
Maintenance of sewerage system, potable water supply system, storm water drainage system, toilets, etc		Contractor
Maintenance of airport maintenance plant and equipment, e.g. trucks, tractors, rollers, mowers, slashers, hand tools, etc		Contractor
Maintenance of airport vehicles including cars, buses and fire trucks (if provided)		Contractor
All items related to safety to be audited twice per year by the Airports and Airways Inspectorates under the terms of the airport licence issued by the Safety and Licensing Division.		
Note : The CNS/ATM service provider will install and maintain any navigation aids and also provide air traffic control services if required (i.e. equipment, facilities and staff).		

ANNEX 2 – OUTLINE OF CONTRACT BETWEEN GOVERNMENT AND AIRPORT COMPANY

Purpose of the contract: to set the relationship between Government and the Airport Company.

The Duration of the Contract: the duration should be for a commercially sustainable period (usually 5 years in normal commercial terms).

The Appointment of the Airports Company: The Airports Company would be appointed as the sole operator of Airports in Afghanistan on behalf of the Government.

Designation of Airports: The Government has the right to designate the classification of airports into international and other classifications based on :

- a) The recommendations of the Airport Company;
- b) The views of the airlines flying to and from Afghanistan;
- c) The Government's needs in relation to customs and immigration.

Establish the "Arms Length" Relationship: The Government will be committed to enforcing safety regulation on the Airport as though it was a privately owned company in order to ensure that safety standards were met.

Operational Independence: The principal objective is to operate as a successful business and to this end to aim to be as efficient a business not owned by a government. With this end in view, it should carry out the activities authorised by its Articles of Incorporation with a view to making a profit, taking one year with another.

Business Plans: The Company will be required to produce annual and 5 year Business Plans. Those business plans must differentiate between CSO's and commercial operations. The Business Plans are also to include investment strategies based on among other things the designation of airports under its management.

Transparent Management: The management of airports should be as close as possible to that of a privately owned Company. The financial reporting should be undertaken on commercial lines and be transparent. The government's control over the finances of the Company must also be transparent so that it is clear what financial objectives the government has set and how far the Company has achieved them.

Government Directives: This provision is mostly aimed at the provision of CSO's. Where the government wishes the Company to carry out functions or provide services which the Company regards as not conducive to the achievement of the principal objective (the making of a profit), it may give the Company a direction to this effect. The Directions are to be open and transparent and should be available publicly.

Government Reserve Powers: If the Company does not succeed over a significant period in meeting its objectives and in particular that it does not succeed in reaching profitability, the Government may wish to intervene to strengthen the management and viability of the Company.

The Government may also exercise price regulation but only in the event that the airport charges constituted an abuse of the Company's monopoly position and it could be shown that the Company was inhibiting the redevelopment of the country.