



WORLDWIDE AIR TRANSPORT CONFERENCE (ATCONF)

SIXTH MEETING

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Agenda Item 2: Examination of key issues and related regulatory framework

Agenda Item 2.4: Fair competition

Agenda Item 2.7 Economics of airports and air navigation services

AIRPORT COMPETITION

(Presented by the Airports Council International (ACI))

EXECUTIVE SUMMARY

This working paper argues that, in an increasingly liberalized market, airports of all sizes are exposed to a variety of competitive constraints. With an increasing freedom of choice for passengers and airlines, airports have to more actively provide the right product at the right price to retain their customers.

Action: The Conference is invited to agree to the recommendations in paragraph 8.

References: ATConf/6 reference material is available at www.icao.int/meetings/atconf6.

1. INTRODUCTION

1.1 Airports used to be considered as natural monopolies. Before deregulation and liberalization of the air transport industry, airports operated in an environment where, with few exceptions, national and State-owned airlines were strictly regulated, with limited freedom to compete across borders. Much has changed in the last twenty years, with the progressive liberalization of aviation markets worldwide.

1.2 Fierce airline competition for passengers also has implications for airports. Airports must now compete with each other for both passengers and airlines, which have significantly more choice than in the past. Airports have had to become more commercially focused. The result is a more competitive and dynamic airport market. However, airports are still too often regarded as monopoly infrastructure providers when the commercial reality is very different.

1.3 Policy makers and regulators have yet to appreciate the extent of the changes that have taken place. This is partly a matter of catching up with a still fast moving market but it is also because the data have not been brought together in a comprehensive way.

2. A RAPIDLY CHANGING ENVIRONMENT

2.1 The changes to the aviation market have been wide ranging over the last twenty years, encompassing deregulation of airline markets; more cost-focused airline business models; technological developments that have increased the operational flexibilities of airlines, as well as the information and choice available to passengers; and more commercially focused airports, often privately owned or run at arms-length from government.

2.2 The resulting competitive pressures on airports have to be seen in the context of the economic nature of those businesses. Airport costs are largely fixed, partly as a result of investment in infrastructure but also because of associated operating costs, including those on safety and security, which vary little with scale of traffic. This gives airports a natural incentive to attract traffic to defray those costs, an incentive which has been accentuated by the growing importance of commercial revenues e.g. from airport retail or car parking (now almost as important overall as aeronautical revenues). Airports are indeed two-sided businesses, engaging in a commercial relationship with both airlines and passengers. The profitability of an airport is therefore crucially dependent on traffic volume as revenues increase in proportion to passenger numbers while costs increase more slowly because of the high fixed cost element. Airports therefore have to respond to increased passenger and airline choice by competing to both retain and attract traffic.

2.3 While their geographical position may confer some advantage relative to consumers who live nearest the airport, most airports cannot achieve the desired scale of passengers by attracting only those very close to the airport. Therefore, competition will play out amongst the increasing number of passengers who have a choice between airports and amongst airlines, the latter now free to fly between any two points in some liberalized markets, like the United States, Europe and Australia/New Zealand. As a result, airport behavior is constrained by the presence of competing airports and by the willingness of passengers and airlines to take their business elsewhere if airport price or quality is not satisfactory. While this sensitivity of consumers to changes in price or quality, and any associated assessment of market power, will vary from airport to airport, there is substantial evidence that the competitive pressures on airports generally are increasing, with a disciplining effect on their behavior.

2.4 A study by the Airports Council International (ACI) Europe demonstrated three main changes driving competitive constraints on airports: more footloose airlines; more choice for passengers; and more active responses from other airports.

3. AIRLINE BEHAVIOR

3.1 Airlines are making use of the freedom they have to fly between airports. They have become more able and willing to switch away from airports if conditions are not right. Analysis of all scheduled airline capacity in Europe between 2002 and 2011 shows a high degree of switching by airlines. Thus:

3.1.1 Many routes open and close: around 2,500 new routes were opened in 2011 while 2,000 were closed (in both cases around 500 more than in 2002).

3.1.2 A high degree of churn: openings are around 20 per cent of the total stock of routes while some 15 per cent of existing routes close every year.

3.1.3 Route closures mean durable traffic loss: traffic is not usually readily replaced when routes close, particularly where the airport has been dependent on a single carrier to operate a route. Even

where multiple carriers have operated a route the withdrawal of one usually leads to a continuing traffic loss for many years. As a result airport profitability suffers.

3.1.4 Bases and hubs: airlines do not only open and close individual routes. Airlines also open and close bases – or vary their size – at individual airports. Such changes in airport bases have even greater impacts on airports than the gradual and continuous churn of routes. So, while only few hub and base closures occur in an average year, airports need to be ready to compete both to defend existing base and hub operations but also to win additional based aircraft.

3.2 These findings demonstrate the increased flexibility of today's airline business models. That flexibility is particularly apparent among point-to-point carriers but the growing trend towards consolidation of hub carriers is giving them more choice than in the past as to where to base their capacity. These findings are also consistent with the publicly declared policies of many airlines. Perfectly understandably, they seek to optimize the profitability of their networks and are prepared to move their aircraft to do so.

3.3 This proven willingness to switch means that the threat of switching has a credibility that gives such airlines a degree of buyer power relative to airports, which is emphasized where they account for a high proportion of an airport's overall traffic. At eight out of ten of Europe's top 250 airports the largest resident carrier delivers more than 40 per cent of total capacity.

4. MORE PASSENGER CHOICE

4.1 Passengers have more choice than in the past. With the rapid development in new routes, a large proportion of today's passengers have a choice between two or more airports. ACI has undertaken a variety of analyses to demonstrate the degree of choice now available to passengers and how it has increased over recent years. This choice is apparent in:

4.1.1 A large geographic overlap: in certain regions there is a high concentration of airports in areas with high population density. In the case of Europe, nearly two-thirds (63 per cent) of European citizens are within two hours' drive of at least two airports. This gives significant scope for airports to compete for passengers.

4.1.2 More choice for local departing passengers: the increase in the number of routes flown means that an increasing number of passengers can find a comparable service at a nearby airport. On average, around half of European airports' local departing passengers on intra-European routes have a choice of more than one reasonably attractive substitute airport for their chosen route, and that choice has increased significantly since 2002. The choice for departing passengers has increased at all of the ten largest European airports.

4.1.3 More choice for transfer passengers: between 2002 and 2011, the share of transfer passengers with a realistic transfer alternative increased from 57 per cent to 63 per cent. In addition, the share of transfer passengers having the option of at least one direct alternative increased since 2002.

4.1.4 More price-sensitive and better informed passengers: not only are passengers becoming more price sensitive, in large part due to the Internet, but the most price sensitive passenger segment, namely leisure traffic, has grown the most. This means that, overall; the market is more price-sensitive than even a few years ago.

4.1.5 Destination switching: the greater share of leisure travel increases the scope for destination switching as holiday makers and airlines are willing to switch one destination for another. As a result, resort airports in Spain, for example, are in competition with airports in Greece, Egypt and Thailand. City break alternatives also compete with one another.

4.2 The combination of these factors suggests that passengers have both a significant and increasing degree of choice over which airport to fly from; and that their propensity to exercise this choice, informed by easily accessible information on the Internet represents a competitive constraint on airports which increasingly have to make themselves attractive to passengers.

5. AIRPORT RESPONSES

5.1 Airports have responded to these changes. Worldwide, airports are increasingly more commercially focused. Their ownership and governance has been transformed over the last few decades. According to ACI's database, 420 airports worldwide have some form of private equity participation. Many publicly owned airports now operate as commercial entities at arms-length from government, while total private ownership is also a feature of many airports worldwide. It is not surprising, therefore, that airports now undertake greater marketing and route development activities. For example, 96 per cent of all European airports, small or large, are actively marketing their airports to the airlines. And there is evidence of increased marketing spend. Airports have also, through incentive schemes and targeted investment, sought to differentiate their products so as to cater for different airline types. New airports have also entered the market. There were 81 more airports in Europe with commercial jet services in 2008 than in 1996. And, at others, there have also been significant increases in capacity. This is all evidence of airports both spurring competition and responding to it in a market where customers have choice.

6. MARKET BASED ASSESSMENT OF MARKET POWER

6.1 In an increasing number of markets worldwide, airports in all size categories are affected by at least one of these constraints: local departure choice; transfer choice; buyer power of the largest carrier; and high volatility of passengers.

6.2 These constraints are increasing, and market power therefore weakening across the board. This applies to all categories of airports, with many of the largest airports subject to significant competition for transfer passengers as well as to airline buyer power deriving from choice of hub by multi-hub carriers. Amongst smaller airports, constraints emanate more from passenger departure choice and airline buyer power, as well as, in some cases, destination switching. Airports of all sizes and categories are therefore subject to many competitive constraints, increasing over time; and the cumulative impact of these competitive constraints is likely to be significant in many cases. While this cannot amount to a determinative view on the market power possessed by airports, there is sufficient evidence to challenge the old presumption of airports having significant market power. Rather, the starting point as elsewhere in the economy should be that the existence of market power needs to be proved rather than assumed.

6.3 Some of the thinking around airport regulation looks more appropriate to the 1980s or early 1990s before airline market liberalization began spreading worldwide, and airline business models had become as flexible as they are today, and passengers had the information and choice they now have. There is now significantly more airport competition, which suggests that the approach to airport regulation needs to be rethought.

7. CONCLUSIONS

7.1 There is increasing competition among airports at a regional, national and worldwide basis.

7.2 Airports are increasingly seeking ways to attract airline customers, including financial packages and marketing schemes.

7.3 Some airlines are well placed to exploit an airport's need to avoid traffic losses, thus giving airlines a significant edge in negotiations with airports.

7.4 At some airports a single airline or airlines within a single alliance may control over 75 per cent of the passenger traffic. For many airports, the potential for growth is limited to few airlines, with airports vying to provide the best deals to these. As evidenced in several airports worldwide, particularly those entirely dependent on low cost carriers, aviation regulation may find itself more concerned with a real case of monopsony power and its associated welfare implications, rather than the traditional monopoly power implications.

8. RECOMMENDATIONS

8.1 The Conference is invited to:

- a) request States to avoid economic regulation of airports in areas where competition is already effective. Retaining regulation in these circumstances is likely to distort behaviors and outcomes to the detriment of customers; and
- b) request States to rethink economic regulation of airports in areas where competition has yet sufficiently to develop to take more account of the competitive constraints that already exist and the potential for competition to develop further in line with current trends. There is a strong case for the regulator standing back and allowing the commercial parties to negotiate commercial outcomes.

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