# AIRPORTS: IS SECTOR REGULATION NOW OBSOLETE?

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# RADICAL CHANGES IN EU AVIATION

- Impact of EU liberalisation 1993/7 - EU airlines free to enter any EU aviation market
- Catalyst for change in airline business models – 1990’s Low Cost Carrier (LCC) ‘revolution’
- Some consequences of freeing-up markets not anticipated

ds1

# LIBERALISATION IMPACTS

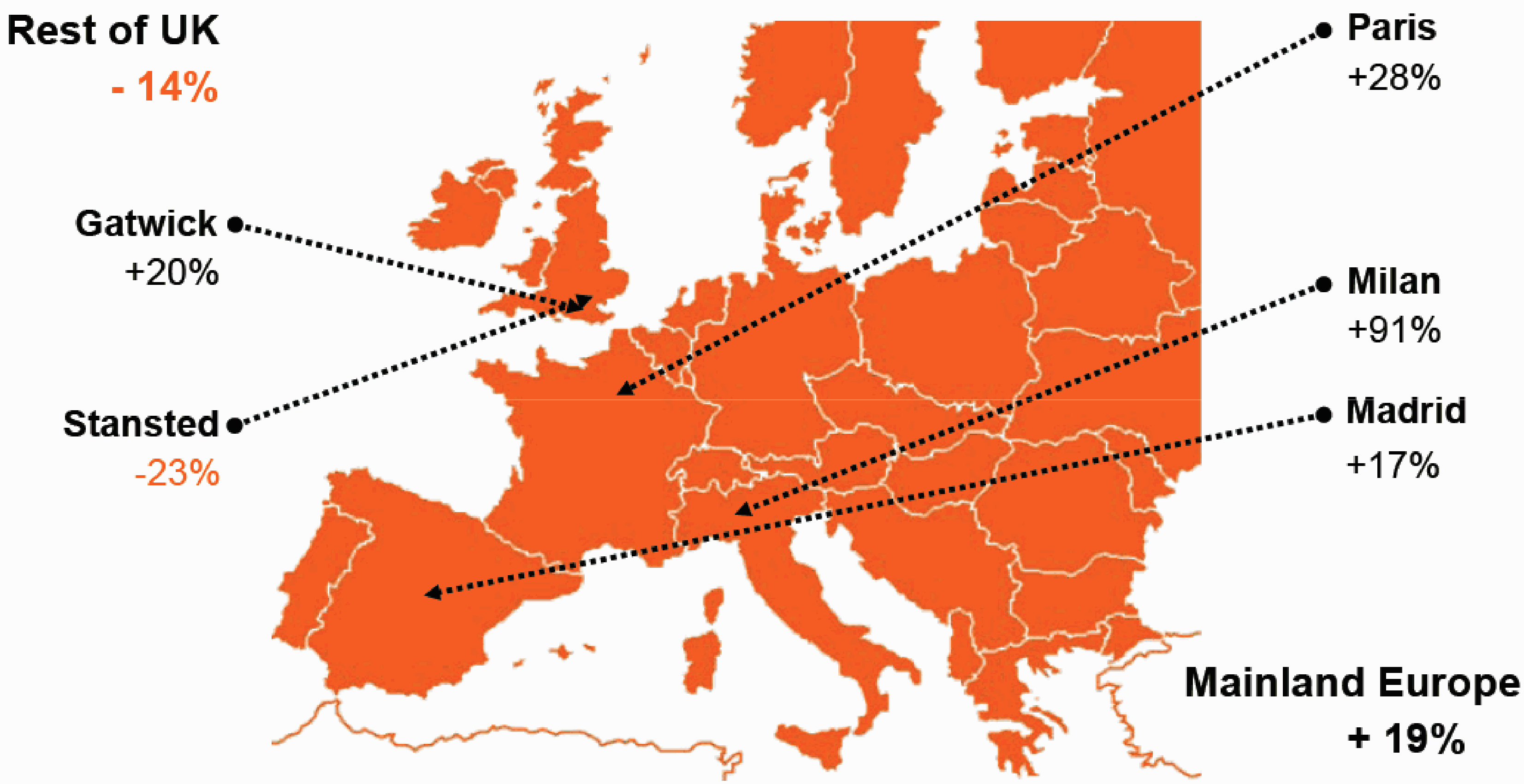
- LCCs now major airlines (Ryanair+easyJet carried 3.5 x more pax than BA in July)
- LCC's view markets on a pan-European basis
- Seeking best return across Europe (huge fleet roll-outs: easyJet 80+; Ryanair 100+ on order)
- Fluid dynamic market with much entry/exit at airport and route level

## Slide 3

**ds1** BA higher RPK

david starkie, 8/14/2009

# Network – winter growth focused on key markets




**Capacity winter 2009, similar to winter 2008**

# CHANGE IN AIRPORT-AIRLINE RELATIONSHIP

- Big increase in countervailing power of airlines
- Competition between airports for contracts and base aircraft (with spill-over to ‘legacy’ airlines)
- Ryanair currently has 45 European bases: “besieged” by European airports offering cut-price deals ( O’Leary July 09).

# STRANDED ASSETS PROBLEM

- Airline/Airport asymmetry
- Airports capital intensive and fixed costs sunk
- Aircraft are ‘capital on wings’ (limited *net* switching costs for LCC’s)
- Thus airport capital at risk from increased market dynamics

# RESPONSE

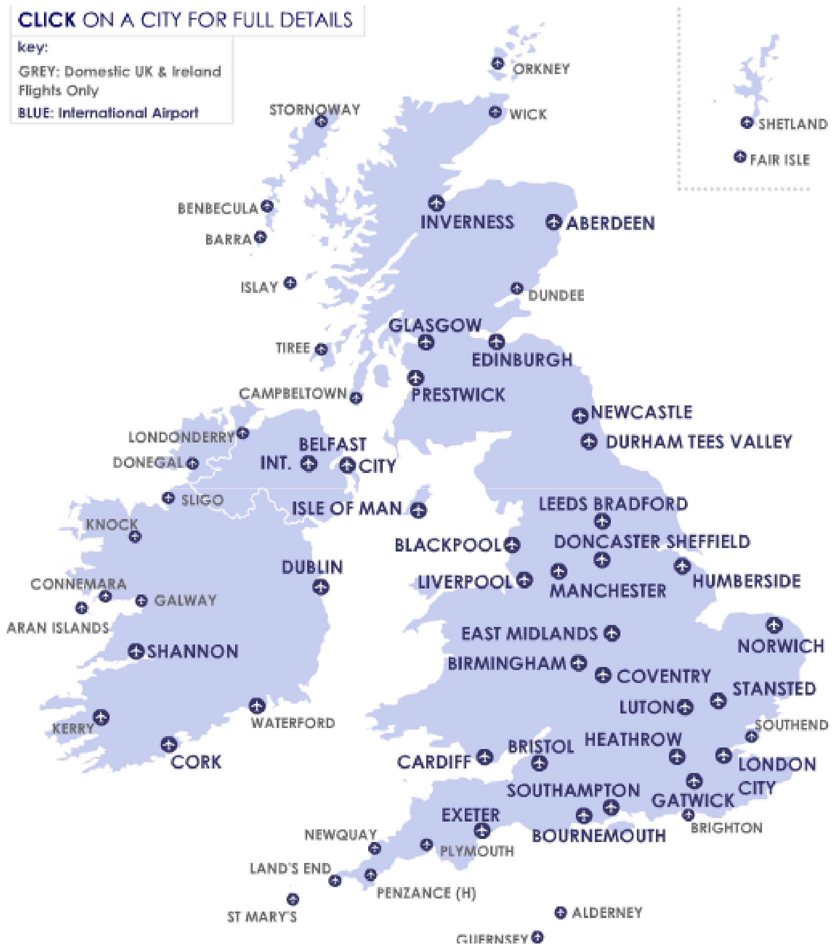
- Long-term vertical supply contracts (replacing ‘posted charges’ and Conditions of Use) to protect airport investment
- Airport obligations: specified charges (heavily discounted), quality of service and investments
- Airline obligations: number of base aircraft, traffic volume guarantees
- Shared risks (charges per pax)
- Non-exclusive contracts

# REDUNDANT REGULATION?

- Bilateral agreements replacing case for regulating to protect downstream airlines
- But what about the retail customer?

# COMPETITION FOR PAX

- Conditioned by catchment characteristics
- Airports (or airlines) cannot price discriminate by pax origin/destination
- CAA isochrome analysis (CC’s supermarket analysis but not for its BAA market inquiry)
- easyJet presentation to analysts (09/08) uses 1 hour drive times
- Catchments show extensive overlaps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ALDERNEY
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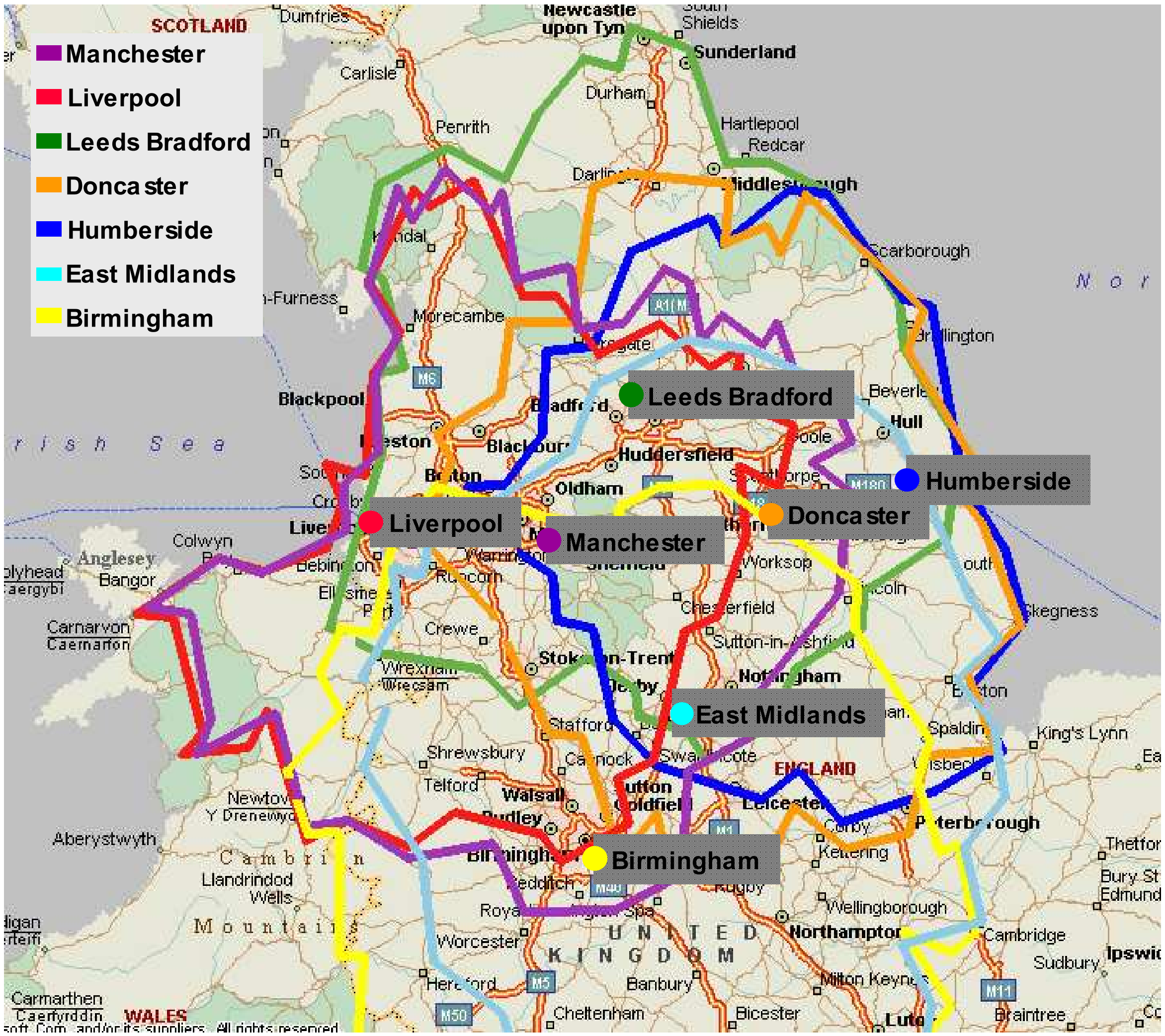
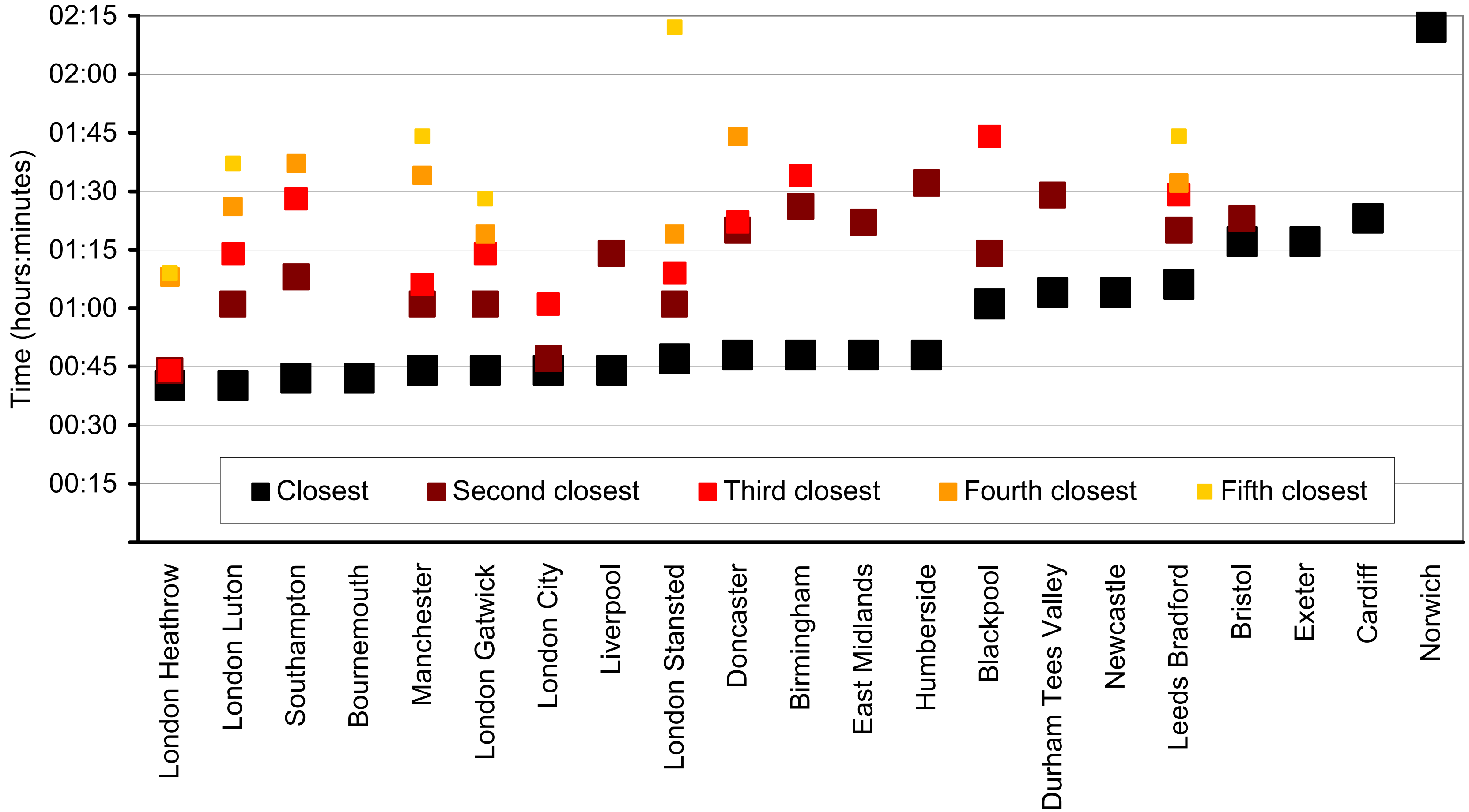
# N. ENGLAND CATCHMENTS: TWO-HOUR DRIVE-TIMES



# DRIVE TIMES BETWEEN MAJOR AIRPORTS



# AIRPORT-AIRPORT DRIVE TIMES

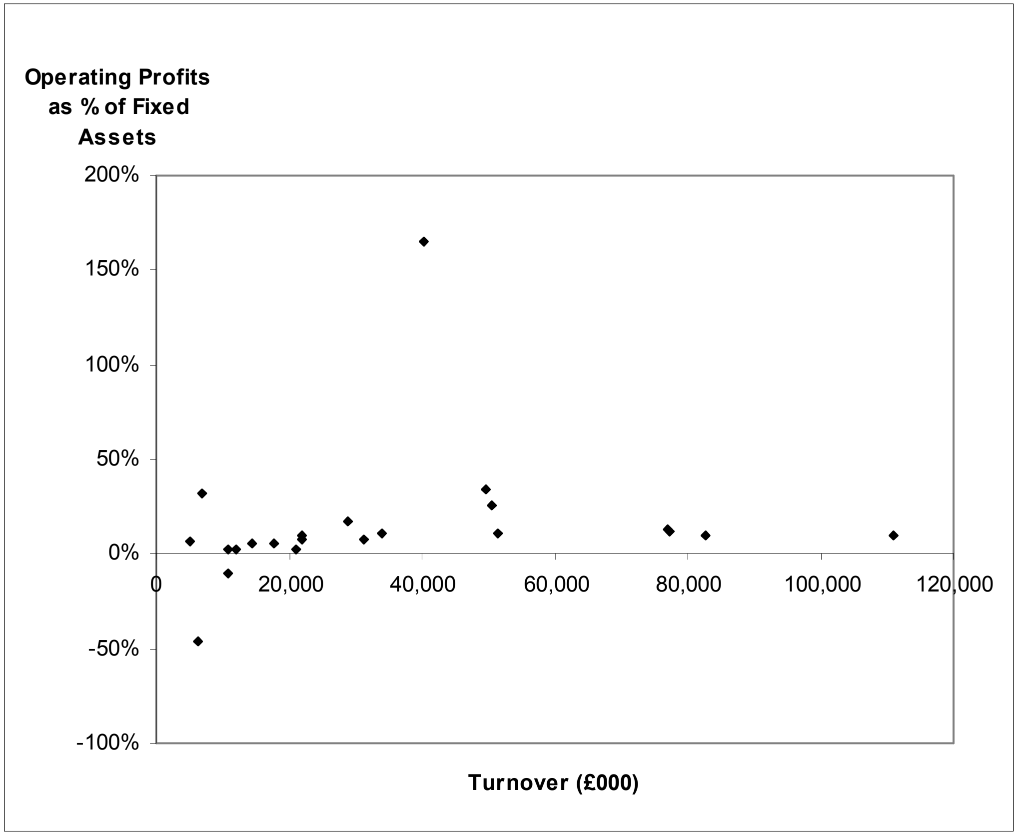
- For main English/Welsh airports (21) all but one airport within 1.5 hours of another
- Mean drive time - 1.0 hour to nearest alternative
- Competitive landscape

# FINANCIAL IMPLICATIONS

- Airports are price-takers
- But generally profitable
- And small/medium sized airports make decent returns (exploiting economies of scope?)

# OPERATING PROFIT: NON-DESGNATED AIRPORTS

## As % of Fixed Assets v Turnover (£'000) 2005-6



# NET RETURN (%)

**Non-designated Airports vis UK Private Non-Financial Sector 2005-06**

| | **2005-06** |
|---|---|
| Airports[a] | 15.2 (10.9[b]) |

| | **2005** | **2006** |
|---|---|---|
| Non-financial service sector | 17.9 | 19.5 |
| Manufacturing sector | 9.1 | 7.8 |
| All private non-financial corporations | 14.0 | 14.5 |

Source: National Statistics and author's calculations

[a] Airports listed in Table 14.3 *Aviation Markets (*Starkie, Ashgate/IEA 2008)

[b] Excluding outliers

# REMAINING ISSUE

- Why price-cap a divested BAA London?
- DfT/CC - because lack of regional capacity stifles competition

  [but see Yarrow (Annex B, CAA Response to CC. 01/09)]
- Even so, absent evidence on withholding of capacity, result is scarcity rents not monopoly rents
- Regulation then becomes an exercise in managing rent-seeking

# RENT SEEKING

- But where are the rents and who is getting them?
  - Ryanair c.60% slots at STA
  - Air France Goup c.50% at LCY
  - BA c.40% at LHR
  - easyJet c.50% at LTN

- This might suggest why airlines are so keen on having airports regulated

- Implies a shift of focus **if** there is to be regulation?

# CONCLUSION

- Airport industry not a network industry requiring sector regulation

- 1986 Airports Act overtaken by  events

- General competition law now sufficient

- DfT 2009 Consultation, brief mention:

  "…while competition law may provide some influence…[the DfT] was not confident that [it] would effectively hold and encourage airport operators to specific standards of behaviour…" (4.11) No further insight into rejection.