LETTERS & NOTES ON REGULATION

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MARKET DEFINITION AND MARKET POWER IN THE AIRPORT SECTOR: COMPETITION FROM OUTSIDE THE RELEVANT MARKET

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The purpose of this note is to draw attention to a generally neglected aspect of assessing market power in the supply of airport services. It develops a point made *en passant* in a paper written by the current author and George Yarrow for the UK CAA in 2010[1]. The paper stressed that, although it was the standard practice in competition assessments to define substitution possibilities from *within* a defined market, sources of constraint on market power also arose from substitutable products defined to lie *outside* the relevant market and that it was the cumulative effect of all the substitution possibilities that determined the own-price elasticity of demand for a product or service.

In the case of airport passenger services, market assessments focus on various product market distinctions such as long-haul vis short-haul flights, premium services vis low-cost services, network services etc. The geographic market analysis focuses upon airport catchment areas and the competitive constraints of other proximate airports[2]. But Starkie/Yarrow drew attention to constraints lying outside airport markets defined in this way. The example given was the substitution possibilities available to *in*-bound tourists in the form of alternative holiday destinations lying outside the relevant market. Specific mention was made of a tourist flying into Blackpool, a UK holiday resort, but resident in Dublin, Ireland who could substitute a flight package to Alicante, Spain; Blackpool Airport would not normally be thought of as competing for passengers with Alicante Airport[3], but competing within a geographic market (of overlapping catchments) that might include the UK airports of Manchester, Liverpool or Leeds.

This type of substitution possibility is likely to be of particular importance when an airport is located in a major tourist region. But even when this is not the case, a relatively small proportion of airport users who are tourists, but resident elsewhere, could have a significant constraining effect on an airport's behaviour; in marked contrast to airlines, airports have limited ability to

[1] Market Definition in the Airports Sector at http://www.caa.co.uk/docs/5/ergdocs/MarketDefAirports.pdf
[2] See, for example, http://www.caa.co.uk/docs/5/geogmarketworkingpaper.pdf
[3] But airports in different parts of Europe might be thought of competing to attract downstream airlines to establish routes and operating bases.

segment the market and price discriminate between passenger types[4]. This limits the possibilities for isolating the relevant market from the competitive effects of substitutable products that lie outside the relevant market.

As always the argument hangs on the empirical evidence. It is reasonably common for airport passenger data to distinguish between scheduled, charter, business and leisure traffic, but not between traffic originating in the airport's local geographic catchment and in-bound traffic. In addition, not all in-bound leisure traffic has, *ex-ante*, readily substitutable alternative destinations. In particular, leisure traffic classified as visiting friends and relatives (VFR) will tend to be destination specific. The data needs to distinguish passengers who are in-bound tourists *per se* because it is this sub-category of leisure traffic that has most substitution opportunities: the individual, couple or family, that *ex-ante* is able to choose from a multitude of different holiday destinations (and activities), some domestic and some foreign.

Statistics derived from the CAA's rolling annual surveys of passengers using UK airports, closely match the required format. The Table below, based on the results of the 2010 survey, shows the proportion of *foreign-resident* holiday-related passengers using the three London airports that currently are considered to have significant market power. (There is also data on foreign-resident business passengers but these are assumed to have more limited substitution possibilities given their journey purpose).

FOREIGN RESIDENT HOLIDAY-RELATED PASSENGERS USING THREE LONDON AIRPORTS 2010

	Foreign Resident Passengers (000)	Percentage of Total Passengers
STANSTED	2,632	14.25
GATWICK	2,546	8.21
HEATHROW	11,556	17.60

Source: Adapted from: *CAA Passenger Survey Report 2010* Tables 19.3, 19.4, 19.12

In addition to foreign-resident tourists flying into London's airports there are UK residents visiting London as tourists making use of domestic air services

[4] See Starkie D. *Aviation Markets: Studies in Competition and Regulatory Reform*, Ashgate 2008, 143-144. One exception is car parking where there is segmentation between short-stay, usually chosen by business passengers, and long-stay generally chosen by (out-bound) leisure passengers.

from Northern Ireland, Scotland and the North of England. Unfortunately, it is not possible to isolate these numbers in the published statistics, but it is expected that the numbers will be relatively small, adding perhaps one or two percent to the in-bound tourist totals shown in the Table.

For London Heathrow, the numbers are surprisingly large; including domestic tourists probably around 20 per cent of total terminating passengers, reflecting Heathrow's position as the premier entry point into the UK. Stansted also receives a significant number of inbound foreign-resident tourists but, because of fewer domestic flights than Heathrow, the overall proportion (including UK originating tourists) is likely to be about 15 per cent. At London Gatwick on the other hand, the overall figure is likely to be less than 10 per cent which probably reflects the fact that the airport still has a large component of outbound inclusive tour traffic using charter flights.

Thus, in any analysis of the market power of airports there is an element of the market where an airport's power is constrained by substitutable products defined to lie *outside* the relevant geographic market. In the case of London's airports this constraint comes from numerous holiday destinations in Europe and elsewhere with which the London airports compete for tourist traffic.[5] For the three regulated London airports, the component of their current total passenger market made up of in-bound tourist traffic subjected to this form of competition, lies between about 10 and 20 percent. This is a relatively large proportion but its significance as a competitive constraint is greater than the figures suggest because of the limited ability of airports to adopt pricing strategies that can segment and isolate this competitive margin.

[5]The situation is analogous to hub airports, like Heathrow, Amsterdam, Frankfurt and Paris Charles-de-Gaulle, competing for long-haul transfer traffic. The percentage of total traffic transferring at Heathrow in 2008 was 35.1 per cent. Once account is taken of in-bound tourism, over half of Heathrow's traffic would fall outside a relevant geographic market defined on the basis of the airport's local catchment area.