



Civil Aviation Authority

Stansted – Market Power Assessment: Non-confidential Version

The CAA's Initial Views – February 2012

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Executive Summary

Rationale and context for the CAA's airport market power assessments

1. Where airports enjoy high levels of market power, it can be appropriate for the CAA to apply economic regulation, so as to improve outcomes for passengers, cargo shippers and airlines.
2. The CAA is committed to ensuring that its regulation of airports promotes choice and value for consumers, whilst also meeting the better regulation principles. In order to deliver on this commitment, during 2011 the CAA embarked upon a project to understand the extent and nature of market power held by the airports that are currently 'designated' for price control regulation: Heathrow, Gatwick and Stansted.
3. This document sets out our work to date to understand the market power held by Stansted. These views are based on the evidence currently available to the CAA. As noted above, we expect that additional evidence will become available before the CAA takes a firm view on the position of each airport. Reflecting this, there are a number of issues that have been left open and, whilst the CAA has sought to highlight where the airport might sit on the market power spectrum, it has not reached a definitive view at this stage.
4. We would like to thank those stakeholders who have engaged with the CAA during 2011, and invested time and money in providing evidence and analysis.

The extent and nature of Stansted's market power

5. The first step in assessing an airport's market power is to consider the markets in which it operates with regard to its various user groups to establish a frame of reference within which to conduct the analysis.

Market definition

6. Stansted provides infrastructure and infrastructure services to its various groups of users, including passenger airlines, passengers, and cargo carriers, and also retailers and car park operators. Each of these user groups could be considered as different 'sides' of the airport market; each with its own characteristics and ability to respond to changes in the price and service offered by Stansted.¹
7. In order to understand the market position of Stansted, it is important first to consider the characteristics of the airport's users including the choices available to them to reduce their use of the airport. As a next step, the interactions and interdependences between the choices made by these different airport user groups need to be analysed to reach a view on their combined impact on the airport.

¹ This treatment of airports as operating in a multi-sided market is described in more detail in the CAA's *Guidance on assessing airport market power*

Provision of services to passengers

8. The focus on Stansted on low-cost carriers has implications when defining the market within which the airport competes for passengers. In particular, there is a degree of uniformity in the requirements of the various passenger types at Stansted, and limits on the extent to which the airport can segregate its offer to passengers or price discriminate between them.
9. We have, therefore, adopted a product market for passengers at Stansted that covers the provision of services for the reception, processing and boarding of passengers, without differentiating between passengers based on their individual characteristics.
10. In order to establish a geographic market for the supply of services to passengers, we consider a range of evidence, including a number of different ways to define an airport catchment. This showed that there were significant overlaps between the catchment areas of Stansted and all of the major London airports, and that they all draw a significant proportion of their passengers from the Greater London area. These overlaps, when combined with the location of the airport and evidence on passenger responsiveness, supports the view that the relevant geographic market covers the South East of England, Greater London and includes a number of districts falling in the East Anglia planning region.

Provision of services to passenger airlines

11. Stansted predominantly serves low cost, short haul, point to point airlines. The airport provides these airlines with a mix of services, including facilities and services for the handling of passengers and those for the transportation of bellyhold cargo, although this is currently not a major requirement of airlines at Stansted.²
12. These services are likely to be available at most mid-sized airports, which implies that there are a relatively large number of airports within the same (airline-facing) product market. However, due to the complexity associated with operating from larger airports, and the difficulty in achieving quick aircraft turnarounds, we do not consider Heathrow to be a close substitute to airlines at Stansted, and that it falls outside of the product market.
13. The demand for capacity at Stansted is significantly higher in the early morning period than throughout the majority of the rest of the day. This reflects the particular requirement of based aircraft for access to an early morning slot – in order to deliver a sufficient number of rotations to deliver high aircraft utilisation – whereas the demand from aircraft operating their services into Stansted (inbound carriers) is more spread out. Combined with this, the airport can vary its charging structures in ways that particularly affect based or inbound carriers, including by varying charges by the time of day, or through varying overnight parking charges. Although it currently does not do so.

²Most passenger flights at Stansted do not carry cargo. Less than 1% of Stansted's cargo is carried bellyhold (CAA airport statistics).

14. If airlines are unable to vary their use of the airport at peak, this might support defining a separate market for the supply of peak capacity. At this stage, the CAA has not been able to reach a definitive view on this issue – which is likely to be important to the overall market power assessment – and has left this issue open at this stage.
15. The geographic market within which Stansted competes for airlines is determined, to a considerable extent, by the fact that the airport predominantly serves short-haul, low cost point-to-point carriers. The business model of these airlines tends to involve basing aircraft at airports of different sizes across Europe from which they offer point-to-point services.
16. This has a number of implications. First, airport charges are also typically a higher proportion of their overall cost base than other carriers, suggesting a higher degree of responsiveness to a given price change than for airlines with other business models. Second, the largest airlines at Stansted have a relatively large number of existing bases across Europe, and a large number of airports to which they already operate, which will tend to reduce the costs associated with moving capacity away from Stansted. However, the airlines at Stansted emphasise the importance of Stansted (and of serving London) to their businesses, and the impact that switching away from Stansted has on their yields. Airlines have also highlighted the lack of responsiveness to recent increases in the level of charges at the airport, which is discussed below.
17. Overall, given the business model of airlines at Stansted and the likely magnitude of switching costs, airports in the Southeast of England are likely to be very close substitutes to Stansted (although Heathrow is likely to fall outside of this market, due to its particular operational characteristics).³ Furthermore, it appears that the switching of marginal airline services is likely to take place over a broader area, such that the geographic market relating to the supply of services to airlines is likely to be European wide.

Provision of services to cargo carriers

18. Stansted provides infrastructure and infrastructure services to cargo-only carriers for the air transportation of cargo. This includes the provision of runway and apron space, as well as providing access to cargo-handlers, access to warehousing facilities, and infrastructure to allow the efficient onward transfer of cargo. In general, we consider that the airport operates in a very broad market, and competes with a number of airports across the UK and Europe for much of this cargo traffic.

The markets in which Stansted operates

19. We have described the markets in which Stansted operates, looking at the airport's passenger-facing and airline-facing activities. However, in practice, these two aspects of the airport's operations are closely linked and there are important interactions between passengers and airlines that are likely to affect the overall assessment of airport market power.

³ This is discussed in the context of the product market.

20. In particular, whilst there may be relatively low direct costs associated with an airline relocating to another airport, the willingness to do so will be affected by whether there are sufficient passengers at alternative airports and whether airline switching away from Stansted typically involves airlines accepting a lower yield. To the extent that airlines are able to switch to nearby airports and attract many of the same passengers, this may reduce the adverse impact on yields. Similarly, for passengers to view an airport as a reasonable substitute they will need to be able to find a suitable alternative flight, which will often need to be to the same destination. The airlines' ability to switch will, therefore, depend upon passenger decisions, whilst passengers' choices are likely to be affected by those of airlines.
21. There are two characteristics of an airport that may strengthen the interaction between passengers and airlines: a high concentration of network carriers or a small airport that is trying to become established. As Stansted does not currently serve network airlines and is a relatively large and well-established airport – indeed, survey evidence confirms a high awareness of the airport amongst passengers – neither of these conditions appear to apply, limiting any effects on the market power enjoyed by the airport. However, the retail revenues generated from passengers are likely to have a significant impact on the airport's incentives to raise prices to airlines, due to the adverse impact that lower passenger numbers have on the profitability of the airport.

Market shares

22. Market shares can provide an indicator of an airport's market position. Even under the narrowest definition, when we limit the market to be short haul flights from the London area, Stansted does not have a high market share, when viewed as a stand-alone airport, and certainly below the level at which there would be a rebuttable presumption of dominance. However, Stansted and Heathrow are both currently owned by BAA, and combining the market shares of the two airports gives very high market shares and which on a UK-wide basis are still as high as 58 per cent.
23. An important aspect of understanding market power at Stansted is to consider the position of the airport at the early morning peak. Looking only at peak periods increases Stansted's market share to 26 per cent (behind Heathrow and Gatwick's 30 per cent), and a combined share with Heathrow of 56 per cent. On some measures, the combined share of BAA-owned airports would support a rebuttable presumption of dominance.

Airline switching

24. The predominant airline business model at Stansted is low-cost, short-haul, point-to-point. In general, these airlines will have invested less at the airport than other airline business models, have multiple bases across the UK and Europe and, due to their more streamlined cost structure, face airport charges that generally account for a bigger proportion of the total costs than they do for full-service network airlines. This implies that there will be a greater incentive, and more ability, for low cost point-to-point airlines to switch in response to a given increase in airport charges, which is consistent

with evidence that highlights that the major carriers at Stansted operate particularly dynamic networks, with the routes flown varying to a significant degree over time.

25. Even if switching costs are low enough to allow airlines to switch, they must have appropriate alternative airports to switch to. A based carrier at Stansted's ability to switch to neighbouring airports may be limited by constrained capacity at other London airports, but those airlines with a network of bases across Europe also have the option of switching to other, non-London airports.
26. The likely magnitude of switching costs, and the sensitivity to airport charges, is mirrored by the evidence of airline switching. In recent months, Stansted has lost several major airlines to Gatwick (Norwegian, Air Berlin and Air Asia X), despite their being some capacity constraints at Gatwick. In addition, easyJet has recently announced its intention to move some of its based aircraft from Stansted to Southend.

Passenger switching

27. We have considered a range of evidence to understand the extent to which passengers might switch between airports. Analysis based on airport catchment areas highlights the significance of catchment area overlaps, particularly over the most densely populated areas (notably Greater London). This suggests that a significant proportion of passengers are likely to be marginal, and able to switch away from Stansted, if a suitable service is available at an alternative airport.
28. Survey evidence is consistent with this general finding, showing that there are significant numbers of Stansted passengers who have previously used another London airport (indicating a degree of willingness to travel to use these airports) and that stated that they had considered alternative airports to Stansted. This is consistent with the survey results that indicated a higher degree of price sensitivity at Stansted and Gatwick, when compared to Heathrow.
29. However, this apparent willingness to switch between airports relies upon passengers being able to find a suitable service at an alternative airport. In this respect, whilst Stansted has fewer route overlaps than other London airports, 74 per cent of passengers at the airport could fly to their chosen destination from another London airport. This suggests that a large proportion of passengers are likely to have the willingness and ability to switch away from Stansted.
30. Further, as only around 10 per cent of Stansted's passengers were on regularly-served routes served by more than one airline at Stansted, it is likely that should an airline remove a service from Stansted, the airport would be more likely to lose the passengers from that route to another airport. Indeed, the interplay between passenger and airline decisions means that the loss of business to an airport resulting from an increase in price may be greater than indicated by the impact on 'marginal' passengers, as services

become unprofitable and prompt those who would have used these services to consider using another airport.

Airport sensitivity to airline and passenger switching

31. In order to understand the impact that passenger and airline switching is likely to have on the airport, it is useful to consider the volume reduction (or 'critical loss') that would render an increase in prices unprofitable. CAA calculations suggest that to render a 5 to 10 per cent price rise unprofitable the airport would need to experience a fall in passenger numbers of between 3 and 11 per cent, depending on the assumptions used. For example, if the price increase applies to the airports overall revenue, a 5 per cent increase would be rendered unprofitable if the airport lost approximately 900,000 passengers, or approximately 1,000,000 passengers if operating costs are saved as passenger numbers fall.
32. Easyjet commissioned Frontier Economics to analyse the potential for airline switching to constrain prices at Stansted, undertaking similar calculations to those set out above. Frontier's paper shows that airlines switching and passenger switching would be insufficient to render a 10 per cent increase in charges unprofitable. However, whilst this analysis makes a useful contribution to the available evidence, the approach taken restricts passenger and airline switching in a number of ways that are likely to understate the actual level of switching. In addition, the data made available to Frontier introduces a further potential source of bias, in that it is based on average easyJet route profitability, rather than the profitability of the most marginal services.

Buyer power

33. Ryanair and easyJet account for a very large proportion of passengers at Stansted, with 68 and 21 per cent shares respectively. Further, whilst Stansted is no doubt an important base for both airlines, the airport accounts for a much lower proportion (17 and 8 per cent) of the airlines' passengers. This implies that Stansted is significantly more reliant on Ryanair and easyJet than these airlines are reliant on the airport, and that there could be a degree of buyer power at the airport.
34. Analysis undertaken for Ryanair by RBB disputes the view that there is a degree of buyer power at the airport. The RBB paper cites the evidence of actual switching that took place following the increase in airport charges faced by Stansted when its agreements with the airport expired, emphasises the importance to buyer power of having an ability to switch, and also argues that there are significant costs to Ryanair relocating aircraft across its European network. Whilst we agree that buyer power requires the combination of scale with the existence of an ability to switch away from the airport, we consider it likely that both Ryanair and easyJet have the ability to switch volumes away from the airport. Indeed, the significant number of bases operated by the two airlines, and recent examples of the airlines opening new bases – including the example of easyJet's switch to Southend

– highlights that there is a significant degree of potential switching from these two airlines.

Competitive price level

35. The interpretation of the evidence on airlines' historical responses to price increases is affected by the relationship between historical prices and the competitive price level. This is particularly important in light of the very significant increase in prices paid at the airport during 2006 and the relatively moderate reductions in volumes that followed.
36. In order to understand whether these price rises were increases towards, or increases above, the competitive price level we have considered a range of sources of evidence.
37. Ryanair provided evidence that showed that its charges at Stansted are considerably higher than at many of the other airports it operates from. However, when Stansted's average charges are compared to those at comparator airports, it reveals that the level of historical charges was particularly low and that the recent price levels are broadly in line with a number of potential comparators. On balance, it appears that the increase in charges around 2006 was an increase towards, rather than above, the competitive price level – in which case, we would not expect there to have been a particularly significant response from airlines switching away from the airport.

Entry and expansion

38. Expansion and/or entry by existing aerodromes may represent a source of competitive constraint, albeit one that is limited by the cost and timescales involved. However, there is relatively limited evidence of significant expansion and/or entry in Stansted's market, with the notable exception of the planned easyJet expansion at Southend Airport, which involves a relocation of capacity from Stansted to Southend.
39. At the time of writing, plans are also being discussed for the expansion of Luton Airport.

Capacity constraints

40. It is clear that there is significant capacity off-peak at Stansted, albeit that this might reduce over time, as demand grows. However, at peak times, there is very little spare capacity. The period over which these capacity constraint holds is currently somewhat limited, relating to 2 or 3 hours, but as demand grows these constraints would be likely to spread to other hours.
41. Capacity constraints at early morning times appear to be a feature at Luton, Gatwick and a number of other European airports. This lack of early morning capacity might reduce the ability of airlines to relocate operations from Stansted, although Gatwick – which is relatively full by European standards – has been able to accommodate a number of new airline services, including a number of services switching from Stansted.

Pricing and behaviour

42. As discussed above, evidence from Ryanair and from other sources paints a somewhat different picture about the appropriateness of Stansted's current prices. However, in general terms, the available evidence tends to support the view that the current price level is reasonable. It is also notable that the airport has flexibility to raise its prices at peak times but has chosen not to do so.
43. The airport has, however, seen a considerable fall in passenger volumes, falling below 18 million, which is back down to 2003 levels. This significant reduction in airline use of the airport follows the increase in charges at the airport, but also coincides with a recession in the UK, and low levels of GDP growth across Europe. Consequently, the reduction in traffic at Stansted could either reflect economic trends or price responsiveness. In this respect, Ryanair says that the fall in traffic is as a result of Stansted failing to offer sufficient discounts, which arguably implies that airlines do have choices of where to expand and at least some ability to switch away when Stansted's relative prices go up.
44. We have also considered whether the airport has responded to the reduction in traffic, and the availability of substantial capacity off-peak, by offering aggressive discounts for growth. The evidence provided by Stansted appears to support the view that it is offering 'competitive' discount offers to support growth in off-peak periods.
45. Overall, the evidence currently available supports the view that there is no SMP relating to the off-peak periods.

Evidence of market power at peak

46. Capacity in early morning periods appears to be particularly important for the low-cost carriers at Stansted. There are capacity constraints at these peak periods at Stansted and also at Luton and Gatwick. This lack of capacity at this crucial time of day may make switching based aircraft away from Stansted more difficult.
47. Nonetheless, switching may take place, but it is likely to be more costly to obtain slots at this time. [X]. Airlines are generally able to obtain the slots they want through slot trading, albeit that the slots at the more popular times are likely to be more expensive.
48. Overall, there remains significant uncertainty about the balance of negotiating power at peak periods, with the incumbent airlines at Stansted placing particular weight on capacity at these times, whilst there are also constraints at a number of alternative airports. Set against this is the general flexibility of the business models of the airlines that use Stansted at peak periods, and the fact that the airport is not currently exercising its ability to increase prices in these periods.
49. On the evidence currently available, Stansted's market power at peak periods could amount to a position of SMP. In order to investigate further this aspect of Stansted's market position, we expect to seek additional

information on airline switching costs, including on the impact that route profitability might have on these switching costs.

Impact of common ownership with Heathrow

50. As noted above, Stansted and Heathrow are still currently under joint ownership. It could therefore be argued that Stansted's competition for certain airlines is muted by concerns about the adverse impact on Heathrow. Stansted disputes this view and argues that BAA is neutral to Stansted's competition with Heathrow.
51. However, we consider that there is a marked contrast between the aggressive marketing of Heathrow and Gatwick to passengers and the relatively low-key approach adopted by Stansted, which could be explained by the continued ownership by BAA.
52. Of course, even if joint ownership were reducing the ability of Stansted to compete, this is not sufficient to conclude that divestment by BAA would be sufficient to remove any SMP held by the airport. Rather, that divestment would lead to a more competitive outcome than continued joint-ownership.

Initial view on the degree of Stansted's market power

53. At this stage, the supply of capacity at peak times is the most likely source of any position of substantial market power at the airport, albeit that we remain concerned that BAA's ownership of Heathrow and Stansted could be reducing the ability of the airport to raise its profile and adopt aggressive strategies to attract passengers and airlines to the airport.
54. There is, however, a lack of clarity about the ability of airlines to reduce their use at peak times, and the evidence on pricing at these times. First, peak capacity appears important to the airlines at Stansted, as it supports the efficient use of their aircraft, making them reluctant to reduce their use of peak capacity. This, however, needs to be set against the apparent flexibility of their business models, which might enable switching to alternative airports.
55. Second, we have seen evidence that supports the view that Stansted's prices, whilst higher than a number of airports across Europe, appear comparable to those serving major conurbations. Furthermore, Stansted does not currently price discriminate between different times of day, despite having the ability to do so.
56. Looking forward, the CAA's view on the market power at Stansted will likely depend upon the following:
 - The evidence available on the barriers to airlines reducing their use of Stansted at peak times, including the impact on airline yields; and
 - Whether, and to whom, the airport is sold by BAA.
57. Whilst the second of these factors is outside of the control of the CAA, we would hope to be able to work with airlines and the airport to obtain better information to reach a firm view on the former.

58. Overall, therefore, we see Stansted as enjoying the least market power of the three airports being assessed and, whilst the evidence is currently not sufficiently clear to reach a definitive view, it appears that any position of substantial market power arises from the relative bargaining positions of the airport and airlines during a relatively narrow peak period. The relative strength of these positions might change over time and be affected by the potential ownership changes at the airport, as well as the balance between demand and available capacity.

Way Forward

59. We welcome stakeholders' views on the information presented in this paper. The CAA is consulting during 2012 on its views, and will continue to work with stakeholders to develop its analysis and to resolve the issues that have been left open at this time. Information about the consultation process, contact information and the dates for a seminar are set out in chapter 1.

1. Introduction

- 1.1 This is the non-confidential version of the CAA's Initial Views on the degree of Stansted's market power. Excisions from the text are marked with [X].

Rationale and context for the CAA's airport market power assessments

- 1.2 Where airports enjoy high levels of market power, it can be appropriate for the CAA to apply economic regulation, so as to improve outcomes for passengers, cargo shippers and airlines. This regulation currently takes the form of a cap on the prices charged by the airport and a series of financial incentives and other obligations to encourage efficient operation, appropriate service quality and efficient investment.
- 1.3 Most UK airports are not subject to this form of economic regulation. Airports are only subject to this regulation if they have (or are likely to have) 'Substantial Market Power' and if economic regulation is likely to improve outcomes. Further, when airports are subject to such economic regulation, it can take a number of forms, and be tailored to the extent and nature of market power.
- 1.4 The CAA is committed to ensuring that its regulation of airports promotes choice and value for consumers, whilst also meeting the better regulation principles. In order to deliver on this commitment, during 2011 the CAA embarked upon a project to understand the extent and nature of market power held by the airports that are currently 'designated' for price control regulation: Heathrow, Gatwick and Stansted. This work also addresses the Competition Commission's view that the CAA should keep competition between airports under review, and that the economic regulation of Gatwick and Stansted might need to adapt to facilitate competition.⁴
- 1.5 These assessments will inform the CAA's views on whether these three airports should continue to be subject to economic regulation, including whether – under the proposed reforms set out in the Civil Aviation Bill (2012) – these airports should be required to hold an economic licence. The work will also allow the CAA to work with stakeholders in developing future regulation of these airports that protects consumers.
- 1.6 We set out below the initial findings of our work to date to understand the market power held by Stansted. These views are based on the evidence currently available to the CAA. As noted above, we expect that additional evidence will become available before the CAA takes a firm view on the position of Stansted. Reflecting this, there are a number of issues that have been left open and, whilst the CAA has sought to highlight where each airport might sit on the market power spectrum, it has not reached a definitive view on the airport at this stage.

⁴ Competition Commission, 'BAA Airports Market Investigation – Final Report', March 2009, paragraph 10.339.

The CAA's approach to the assessing airport market power

- 1.7 In reaching an initial view as to the degree of market power of Heathrow, Gatwick and Stansted, we have followed the approach set out in the CAA's *Guidance on the assessment of airport market power*⁵.
- 1.8 There has been extensive stakeholder engagement, including with the three regulated airports as well as Luton and Manchester, and the main airlines of Heathrow, Gatwick and Stansted. This engagement has taken the form of:
- meetings with stakeholders to discuss relevant evidence;
 - stakeholder feedback and discussion on work in progress;
 - the submission of evidence by stakeholders;
 - some stakeholders, including both airports and airlines, have commissioned reports by economic consultancies; and
 - the CAA's stakeholder workshop held on 15 November 2011 to set out its emerging views.
- 1.9 We have also published a number of working papers in 2011:
- on the general market context⁶;
 - catchment area analysis⁷; and
 - passengers' airport preferences⁸.
- 1.10 While undertaking the market power assessments, we also sought the advice of an economic and a legal consultant.
- 1.11 The initial views expressed in this assessment are based on the evidence currently available to us. We expect that additional evidence will become available before we take a firm view on the position of each airport. Reflecting this, there are a number of issues that have been left open and, whilst we have sought to highlight where Stansted might sit on the market power spectrum, it has not reached a definitive view on the airport at this stage.
- 1.12 We would like to thank those stakeholders who have engaged with us during 2011, and invested time and money in providing evidence and analysis.

Way Forward

- 1.13 We welcome stakeholders' views on the information presented in this paper. There are two periods over which interested parties can engage with the CAA:

⁵ CAA *Guidance on assessing airport market power*

<http://www.caa.co.uk/docs/5/Final%20Competition%20Assessment%20Guidelines%20-%20FINAL.pdf>

⁶ CAA *UK Airports Market – General Context* September 2011

<http://www.caa.co.uk/docs/5/20110905%20Market%20Context-FINAL.pdf>

⁷ CAA *Catchment area analysis* October 2011

<http://www.caa.co.uk/docs/5/Catchment%20area%20analysis%20working%20paper%20-%20FINAL.pdf>

⁸ CAA *Passengers' airport preferences – Results from the CAA Passenger Survey* November 2011

<http://www.caa.co.uk/docs/5/Passenger%20survey%20results%20-%20FINAL.pdf>

- Those wishing to share their **initial views** with the CAA should aim to submit any material to the CAA **by 24 March 2012**, so that these can inform the CAA's next Q6 price control publication, which is scheduled for April 2012.
 - Those wishing to engage on the **detail of the competition assessments** are invited to engage with the CAA **during 2012**, so that any additional evidence and analysis can be incorporated in an updated assessment of airport competition, scheduled for publication in late 2012/early 2013.
- 1.14 If you would like to discuss the contents of this paper, and the CAA's work on assessing airport competition, in the first instance please contact Alina Jardine Goad on 020 7453 6229 / alina.jardinegoad@caa.co.uk or Alexander Dünki on 020 7453 6212 / alexander.dunki@caa.co.uk. You can also contact Chris Hemsley on 020 7453 6237 / chris.hemsley@caa.co.uk.
- 1.15 If you would like to discuss the economic regulation of Heathrow, Gatwick and Stansted, including the Q6 work programme, please contact Richard Moriarty on 020 7453 6203 / richard.moriarty@caa.co.uk.
- 1.16 The CAA will also be hosting a **seminar**, to take forward the work on price control design for Stansted, on **16 March 2012**. The output of these seminars – and other discussions with stakeholders – will be brought together into a publication in April 2012, which will frame the debate on the development of regulation and, where appropriate, support the process of Constructive Engagement. If you would like to register your interest in the seminars, please contact Barbara Perata-Smith, on 020 7453 6202 or Barbara.PerataSmith@caa.co.uk.
- 1.17 There will also be an opportunity to engage on the CAA's initial views on airport market power during 2012, which will also allow the CAA to work with stakeholders to narrow down those areas of uncertainty that currently exist. Stakeholders will also be able to submit further evidence – and comment on the CAA's initial views – during this period. At this stage, the CAA expects to publish its next substantive analysis of airport market power in late 2012/early 2013.

2. The markets in which Stansted competes

- 2.1 This chapter describes Stansted's business, its infrastructure and the customers it serves. It looks at the varying requirements of different customer groups and then goes on to analyse the product and geographic markets for Stansted.
- 2.2 Reflecting the importance of the linkages between Stansted's various customer groups, the final section of this chapter brings together the previous sections and draws out the implications of these interrelations for market definition.
- 2.3 We note that there is a degree of repetition in the evidence cited in this chapter and in chapter 3. This reflects the fact that both chapters are seeking to understand the strength of the competitive constraints on Stansted.

Stansted's business

- 2.4 Stansted provides infrastructure and infrastructure services to its various groups of users, including passenger airlines, passengers, and cargo carriers. Each of these user groups has its own characteristics and infrastructure and service requirements from Stansted, which are described below.

Provision of products and services to passengers

- 2.5 Stansted provides infrastructure and infrastructure services to passengers, including:
- aeronautical services, including security clearance and flight information and surface access infrastructure; and
 - non-aeronautical services, including retail space and car parking.
- 2.6 Stansted does not currently directly charge passengers for the use of the airport.⁹ However, it nevertheless supplies a number of services to passengers in their use of the airport and can vary its offering in ways that vary the attractiveness of the airport to passengers. It also charges passengers directly for the use of their car parks.

Provision of products and services to passenger airlines

- 2.7 Stansted also provides aeronautical and non-aeronautical infrastructure and infrastructure services to passenger airlines. This includes facilities and services for the handling of passengers and those for the transportation of bellyhold cargo, although this is currently not a major requirement of airlines at Stansted.¹⁰
- 2.8 These services include:
- aircraft-related aeronautical services (e.g. facilities for landing, parking, and taking-off of aircraft);

⁹ There is no statutory prohibition on the airport choosing to charge passengers. Indeed, a number of regional airports in the UK (and a number of major airports overseas) impose charges directly on passengers, in the form of 'Airport Development Fees' and 'Passenger Facility Charges'.

¹⁰ Most passenger flights at Stansted do not carry cargo. Less than 1% of Stansted's cargo is carried bellyhold (CAA airport statistics).

- airline-facing non-aeronautical services (e.g. information technology services, check-in desks and Common Use Self-Service (CUSS)); and
- 2.9 providing access to staff and supporting services procured by airlines (staff security clearance, staff car parking, access to groundhandlers, access to catering suppliers, etc).
- 2.10 We are adopting a working assumption that all of these services should be included in the product market within which Stansted operates, as the failure to supply any one of these services would severely hamper the economic operation of a passenger airline, which means that any market power enjoyed by virtue of the ownership of the runways, taxiways and terminals would also be likely to be enjoyed over all of these services.¹¹
- 2.11 Airports also provide other services that are, to a greater or lesser degree, ancillary to the operation of passenger services, such as office rental to airlines or tour operators, either within terminals or at nearby locations. We are adopting a working assumption that the provision of these services forms part of a wider market for, in this case, office space.

Provision of products and services to cargo carriers

- 2.12 Stansted provides infrastructure and infrastructure services to cargo-only carriers for the air transportation of cargo. This includes the provision of runway and apron space, as well as providing access to cargo-handlers, access to warehousing facilities, and infrastructure to allow the efficient onward transfer of cargo.

Provision of access to Stansted's infrastructure and services to third party service providers

- 2.13 Many services for airport users are provided by third party service providers. For airlines and cargo carriers, these service providers (contracted by them) include ground- and cargo-handlers respectively, and maintenance and repair operations.
- 2.14 For passengers, these service providers include food and drink, and providers of other retail services (e.g. bureau de change). In order to provide these services, suppliers typically need to rent terminal space and to obtain access to the landside and airside facilities for their staff and to bring in stock.

The use of market definition

- 2.15 Defining the relevant market is usually the first step of any competition assessment. It provides the context for the analysis by setting out the relevant set of products and geographic areas which encompass the closest substitutes for the products and services of interest.
- 2.16 However, as noted in our guidelines, market definition is not an end in itself, but rather provides a frame of reference for the analysis of competitive effects.

¹¹ We note here that access to the airport, the construction and operation of its terminals and runways are all controlled by Stansted Airport.

- 2.17 In practice, in differentiated product markets, it can be difficult to draw a line around a group of products with a varying degree of competitive constraint on each other to define the market. In such circumstances it is appropriate to consider the degree of competitive constraints faced by the product in question in the round, regardless of whether they arise from within or outside a defined relevant market.
- 2.18 Markets are generally defined in two dimensions: product and geographic. The CAA's Guidelines set out the basis on which we have carried out the market definition analysis. It should be noted, in particular, that in the absence of sufficient data and given the difficulty in establishing the competitive price level, rather than carry out a quantitative hypothetical monopolist test we have assessed available evidence on the products supplied by the airport and airline and passenger preferences using the principles of the test.
- 2.19 In particular, we have looked at the ability of airlines and passengers to switch their business away from the airport, the ability of other airports to begin supplying a substituted product to that of Stansted and the effect of these factors on the profitability of any price rise by Stansted.
- 2.20 The CAA's approach is set out in more detail in the CAA's *Guidance on the Assessment of Airport Market Power*.¹²
- 2.21 The remainder of this chapter considers the product and geographic market definitions from the perspective of airlines and passengers, looking at both demand and supply side substitutability. We then draw this evidence together and consider the effects of the interdependence of demand from the different user groups and the implications of this on overall assessment of the markets in which Stansted operates.

Product market definition

- 2.22 The following section considers each of Stansted's main customer groups. It looks at the characteristics of these groups and whether there are separate segments within these groups that have different product requirements.¹³
- 2.23 By looking at the choice sets available to each of Stansted's customer groups (and, if relevant, subgroups) on a product dimension and the ability to switch between the different alternatives, we have assessed the potential for these customers to react to an increase in charges by the airport. We have then suggested product market definitions that include all alternatives that customers can easily switch between.

Passenger demand side substitutability

- 2.24 A number of passenger sub-groups can be distinguished using various characteristics:
- journey purpose;

¹² 'Guidance on the assessment of airport market power', CAA, April 2011

¹³ We refer to market segments where we want to describe and delineate different groups of airlines and passengers that are likely to have distinct features. This is not the same as describing these as separate economic markets; we assess in this paper to which degree there might be separate markets for different market segments, or to which degree they might suggest one, albeit differentiated, product market.

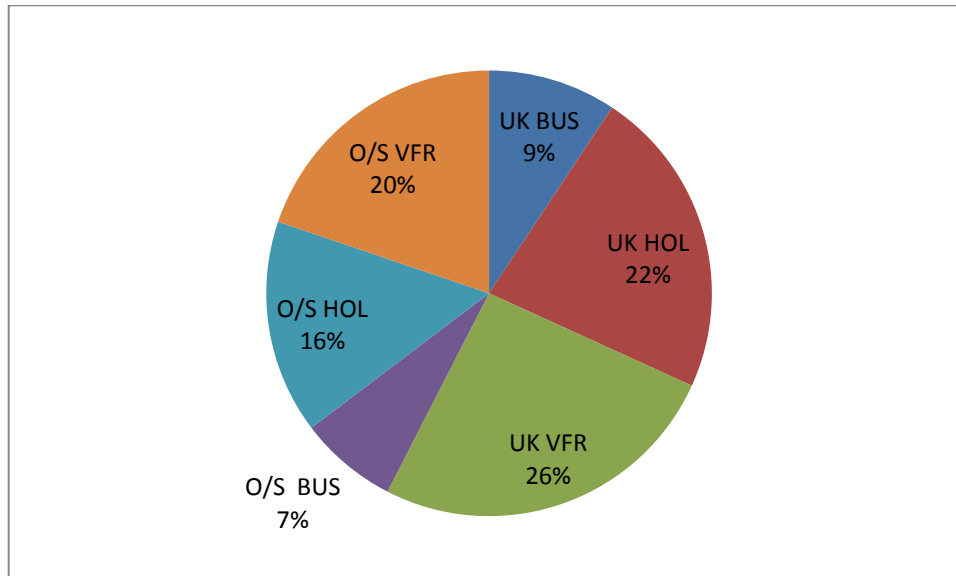
- destination; and
- passenger origin (inbound, outbound and connecting passengers).

2.25 We consider the relevance of these subgroups at Stansted and whether they have varying requirements that might imply separate product market definitions. We then look at passengers' ability to switch away from the airport.

Journey purpose

2.26 One way to distinguish passengers is by their journey purpose. Figure 1 below shows the passenger breakdown by passenger origin¹⁴ (UK or foreign and journey purpose at Stansted (Holiday, Visiting Friends and Relatives (VFR), or Business).

Figure 1 Passenger breakdown by passenger origin and journey purpose



Source: CAA analysis of the CAA Passenger Survey (2010)

2.27 Stansted serves both business and leisure passengers. Despite the fact that its airlines do not generally offer a premium service, 16 per cent of its passengers are business passengers. In addition, there is a recent trend towards a number of airlines offering additional services that might be particularly attractive to passengers travelling on business, such as priority boarding and reserved seating, which may lead to an increase in business travel on these airlines at Stansted.

2.28 In terms of the business/leisure split, it could be argued that the product market for business passengers may be narrower than that for Holiday and VFR passengers if they require the airport to provide different services, service quality and/or infrastructure that only business passengers require. However, the majority of the airport's services are offered to all passengers, irrespective of their journey purpose. Indeed, there is no direct way for the airport to distinguish passengers travelling on business from those travelling for leisure purposes. To the extent that these two passenger groups have

¹⁴ The CAA's survey asks people to identify where they reside. This is used as a proxy to identify whether passengers are originating from a UK district, or from overseas.

different car parking needs, for example business passengers are likely to have more of a preference for short stay or valet parking, there may be some potential for price discrimination here, but we do not consider this sufficient enough to warrant separate market definitions.

- 2.29 Stansted does provide some services – through third-party suppliers – that are particularly likely to be attractive to passengers travelling on business, such as fast-track security and premium lounges. These facilities are not restricted to business passengers and, given that business passengers can choose whether to purchase these extra services, there does not appear to be a strong rationale for identifying a sub-market for the provision of airport services to business passengers.
- 2.30 A very large proportion (84 per cent) of Stansted's passengers are travelling for leisure purposes, which can be split into those travelling for a Holiday (38 per cent of Stansted) and for VFR (46 per cent). This highlights that Stansted has a particularly high proportion of its traffic accounted for by VFR traffic, relative to other UK airports.
- 2.31 In general, passengers travelling for VFR purposes are less flexible in terms of their destination than those travelling on a holiday, who may be able to alter their destination. However, we have not identified any strong reason why holiday and VFR passengers would consume different airport services (albeit that the retail spend between these groups may differ).
- 2.32 Furthermore, individual services will typically have a mix of Holiday and VFR (as well as business) passengers, making it difficult for the airport to discriminate between these passengers. Consequently, there does not appear to be a strong rationale for identifying a sub-market for the provision of airport services to either Holiday or VFR passengers.

Destination

- 2.33 The vast majority of Stansted's passengers are short-haul, with only two per cent travelling to long-haul destinations. This means that to understand the market power of the airport, it is important to understand the characteristics of short-haul passengers. Indeed, the very high shares of passengers accounted for by short-haul flights implies that there is unlikely to be any need to define a sub-market by destination type.
- 2.34 This focus of Stansted's operations on short-haul services has implications for the choices available to passengers. In particular, short-haul passengers typically face a wider choice set than long-haul passengers, as there are more airports offering short-haul services and are more route overlaps between short-haul services at different airports. In addition, for those passengers who are flexible on their destination airport¹⁵ there are more short-haul destinations, at more airports, increasing the choice set further.

¹⁵ Some passengers might be seeking a "city break", "ski holiday" or "Spanish beach holiday" and be willing to choose between services to a similar type of destination.

Passenger origin (inbound, outbound and connecting passengers)

- 2.35 Stansted provides services to both departing/outbound and arriving/inbound passengers. The infrastructure services required by inbound and outbound passengers differ somewhat, as outbound passengers typically have access to more significant (airside) retail offerings, and also require security clearance. However, there is a significant overlap in the services offered to these two groups. Furthermore, given the significant proportion of passengers who travel through the same airport for both legs of their trip, any attempt to discriminate between inbound and outbound passengers would not appear likely to be effective, as it would still affect the overall trip cost faced by passengers. Reflecting this, we do not consider that there is a need to distinguish between these groups in terms of the product market.
- 2.36 In respect of how passengers arrive at the airport, the majority of Stansted's passengers arrive at the airport by surface travel, although there is a small proportion of passengers who connect between services. These passengers are 'self-connectors', as the airlines at Stansted do not offer through-tickets or formally support connections between services. Reflecting this, passengers do not therefore require transfer facilities, such as airside security clearance and systems for connecting baggage.
- 2.37 This lack of connecting passengers, supports the view that the airport is competing to attract passengers onto point-to-point services, which is consistent with views expressed to the CAA by the airport and by airlines.

Ability to switch

- 2.38 The above discussion highlights that the passengers using Stansted share common key requirements and that there are factors that limit the airport's ability to differentiate its offer in a way that might support a narrowing of the passenger-facing product market.
- 2.39 There are few direct costs to passengers switching between airports, other than the costs involved in travelling to an alternative airport (a factor that is considered in the context of the geographic market, below).
- 2.40 However, the ability of a passenger to switch away from the airport will depend on whether or not a suitable destination is available from an alternative airport. Whilst the airport can structure its charges in ways that can encourage particular services (such as targeted discounts to new destinations), route choice is determined by the airlines rather than the airport. Reflecting this, we have not identified a strong argument to narrow the market in terms of different destinations. The impact of route overlaps on switching is examined in the final section of this chapter.

Summary – Product market: passengers

- 2.41 In terms of the airport product, there is a degree of uniformity in the requirements of the various passenger types at Stansted, and limits on the extent to which the airport can segregate its offer to passengers or price discriminate between them.

- 2.42 In summary, therefore, it seems that the appropriate product market for passengers at Stansted should be the general provision of airport infrastructure and infrastructure services to passengers. This is likely to cover a range of aeronautical and non-aeronautical services that are required for the reception, processing and boarding of passengers.
- 2.43 However, the choice set for passengers will depend on whether or not a suitable destination is available from the alternative airport, which we have considered in the context of the geographic market, below.

Passenger airlines demand side substitutability

- 2.44 Airlines' infrastructure requirements are likely to differ according to their business model and the type of service they offer. These differing requirements may affect the choices available to different airlines and the airports with which Stansted competes.
- 2.45 In this section we consider different ways of distinguishing between airlines and whether this has any implications for product market definition, including:
- short-haul vs. long-haul;
 - airline business model; and
 - based vs. inbound
- 2.46 We then go on to consider airlines' ability to switch.

Short-haul vs. long-haul

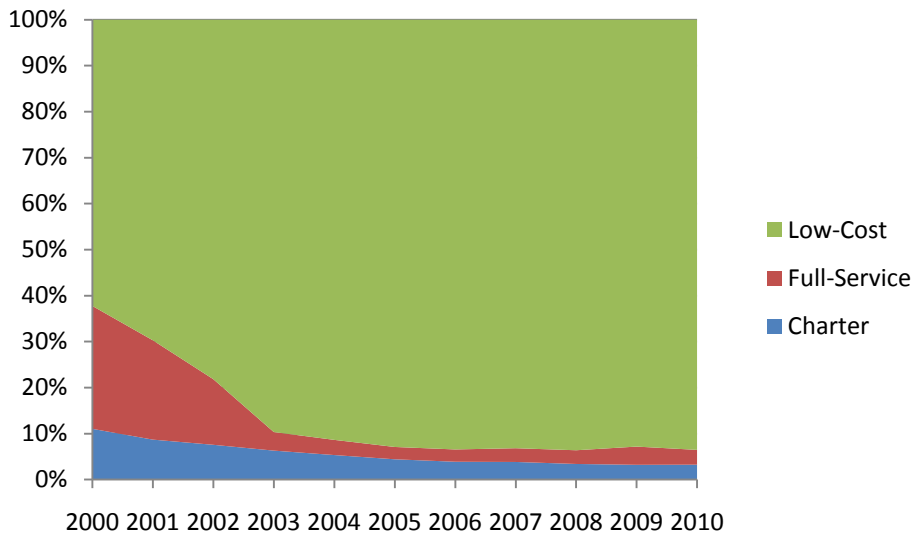
- 2.47 In 2010, 98 per cent of Stansted passengers' final destinations were domestic or European, with just 2 per cent of passengers flying long-haul, a figure that is likely to be reduced further by the removal by Air Asia X of its services from the airport.
- 2.48 The infrastructure needed to operate a short-haul route versus a long-haul route are broadly similar, in that all airlines have a minimum requirement in terms of runways, aprons and terminal facilities. However, long-haul routes are more likely to be served by larger aircraft – requiring a higher specification of runway – and they are more likely to carry bellyhold cargo, which can add to the requirements of long-haul operations, relative to those operating short-haul.
- 2.49 However, given that the vast majority of routes from Stansted are short-haul, it is not necessary to consider any split for market definition purposes between the supply of infrastructure for short-haul and long-haul services, as it is unlikely to affect the overall assessment of market power.
- 2.50 Looking ahead, the airport may attract higher volumes of long-haul services, which might have implications for the appropriate market definition. We consider the airport's future growth, and efforts to attract additional services, in chapter 3.

Airline business model

- 2.51 Stansted predominantly serves low cost, point-to-point airlines. Figure 2 below gives the airline business model breakdown at Stansted over the last

ten years. This shows that by 2010, at least 94 per cent of Stansted passengers flew on low-cost carrier (LCC)¹⁶ airlines, with three per cent flying charter and three per cent full-service carriers (FSC).

Figure 2 Share of Stansted’s passengers by business model, 2010



Source: CAA Airport Stats, 2010

- 2.52 Given that Stansted does not currently serve FSC or charter airlines to an appreciable extent (despite Stansted’s attempts to attract such airlines – see chapter 3), this implies that the provision of facilities to these airline business models is unlikely to determine the airport’s market power. In the remainder of this paper, we therefore concentrate our analysis on LCCs (operating short haul, point-to-point services), since it is the interaction between the airport, these airlines and their passengers that will determine the extent of Stansted’s market power.
- 2.53 In terms of their infrastructure requirements, LCCs have fewer needs to FSCs, particularly those operating networks with connecting passengers. LCCs do not require facilities to accommodate transfer passengers and usually require more basic terminal facilities than FSCs.
- 2.54 The LCC business models do, however, rely upon achieving high levels of utilisation of their aircraft, by reducing the time that aircraft are on the ground. This can be achieved by efficient turnaround times, short taxiing times and low levels of airfield delay. These requirements can limit – to a degree – the airports that no-frills airlines view as being reasonable alternatives to Stansted. In particular, relatively uncongested airports, or those supporting reliable and efficient turnarounds, may be close alternatives (for this dimension of comparability).
- 2.55 Consequently, congested airports or those with relatively high levels of airfield delays and relatively low levels of punctuality might not be viewed as being

¹⁶ We generally adopt the term ‘low-cost carrier’ to identify airlines, such as easyJet, Ryanair, Monarch and Jet2 that operate point-to-point services. These airlines are often referred to as ‘no frills’ airlines. In reality, individual airline business models vary, and we use these terms to differentiate these airlines from ‘full-service’ airlines, that offer different ticket classes, support connecting traffic and tend to operate using a more diverse fleet of aircraft.

close alternatives to Stansted. For this reason, we do not consider that Heathrow is likely to be viewed as a reasonably close alternative airport for most of the airlines operating from Stansted¹⁷.

- 2.56 A further factor that can affect the utilisation of aircraft is the ability of airlines with aircraft based at the airport to leave early in the morning. Early morning departures increase the likelihood that the airlines are able to achieve a high number of rotations each day. This may have implications for the ability of airline to change their usage pattern of Stansted across the day. This is discussed in more detail below.

Based vs. inbound

- 2.57 Another way in which airlines can be distinguished is by whether or not they base aircraft at Stansted overnight, or whether they are based at another airport, their first service to Stansted being operated inbound.
- 2.58 As noted above, the no-frills airlines at Stansted are likely to place a particular premium on high levels of aircraft utilisation, which means that when they base aircraft at the airport they will also place a premium on the ability to depart from the airport early in the morning. This preference for early-morning departures may also be compounded by the preferences of some passengers (notably those travelling for business) to leave relatively early, in order to arrive at their destination in time to carry out a full day's work, although the share of business passengers at Stansted is relatively low.
- 2.59 In contrast, whilst operators of inbound aircraft might also place a premium on high levels of utilisation, the differing sector lengths involved in flying into Stansted spreads the arrival times over a broader period of the day, relative to the usage pattern of the first wave of departing aircraft.
- 2.60 So while the demand for slots is more spread out for non-based aircraft, a based aircraft will have a particular requirement for access to an early morning slot. This raises the question of whether the airport is able to differentiate its offer between based and inbound aircraft to such an extent that they should be considered to be separate product markets.
- 2.61 In principle, the airport can vary its charging structures in ways that particularly affect based or inbound carriers, including by varying charges by the time of day, or through varying overnight parking charges. The airport's ability to differentiate between inbound and outbound services will also depend upon the extent to which the airlines operating these services can respond to any price change and reduce their use of the airport. In this context, it is relevant that the main airlines at Stansted operate both based and inbound aircraft, and have a number of bases across Europe which would, in principle, allow them to switch outbound operations to be inbound (and vice-versa).
- 2.62 However, a switch between outbound and inbound operation changes the flight timings that can be offered to passengers. To the extent that local passengers have strong time preferences, this might act as a barrier to

¹⁷ We discuss later the extent to which passengers might still view the two airports as being substitutes.

airlines switching between inbound and outbound operations. The relatively low levels of business passengers at Stansted might suggest a higher degree of flexibility over departure times than at London City or Heathrow, which both have particularly high proportions of business travellers (33 and 63 per cent respectively)¹⁸.

- 2.63 On the basis of the evidence available, it might be appropriate to distinguish between the supply of infrastructure to based and inbound operators, in light of the potential costs associated with switching between based and inbound operation, and the emphasis placed by airlines at Stansted on operating based services at peak times. Further analysis of this issue would require airline data on route revenues, to allow comparisons between outbound and inbound profitability, so as to understand better the costs of switching an outbound service to an inbound one. This would allow the CAA to understand if switching services in this way would undermine an attempt to raise prices above the competitive level to on or other of these groups.
- 2.64 These issues are considered in more detail in the context of whether there are ‘temporal’ markets, from paragraph 2.78.

Ability to switch

- 2.65 The switching costs of airlines are considered in more detail in chapter 3, however as the ability of airlines to switch away from Stansted will affect the assessment of the relevant market, we also discuss this issue below (in respect of those factors that affect the product market) and in the following section, in the context of the geographic market.
- 2.66 The airlines at Stansted are predominantly LCC airlines. The infrastructure and service level requirements of these airlines will tend to be below those of a FSC airline. As discussed above, LCCs will typically not require facilities to connect passengers and baggage between flights, or to facilitate the carrying of bellyhold cargo, or facilities targeted at premium passengers, such as business lounges.
- 2.67 Furthermore, the aircraft flown by Ryanair¹⁹ and easyJet²⁰ can operate from a wide range of airports across the UK and Europe, albeit that some commercial airports – such as Southampton and London City – have runways that do not allow some common aircraft types to operate. These factors mean that the choice set of the major airlines at Stansted is relatively wide (below we discuss factors that might limit the ability to exercise these choices, in the context of the geographic market).
- 2.68 Indeed, Ryanair, the main airline at Stansted, currently also operates at a number of much smaller airports than Stansted, which highlights that its minimum requirements are relatively low and below the level of infrastructure available at Stansted (with its long runway and cargo facilities). This implies

¹⁸ See Figure 14 of ‘UK Airports Market – General Context’, CAA, September 2011

¹⁹ As at November 2011: 275 Boeing 737 800s (Ryanair Half Year Results, Nov 2011)

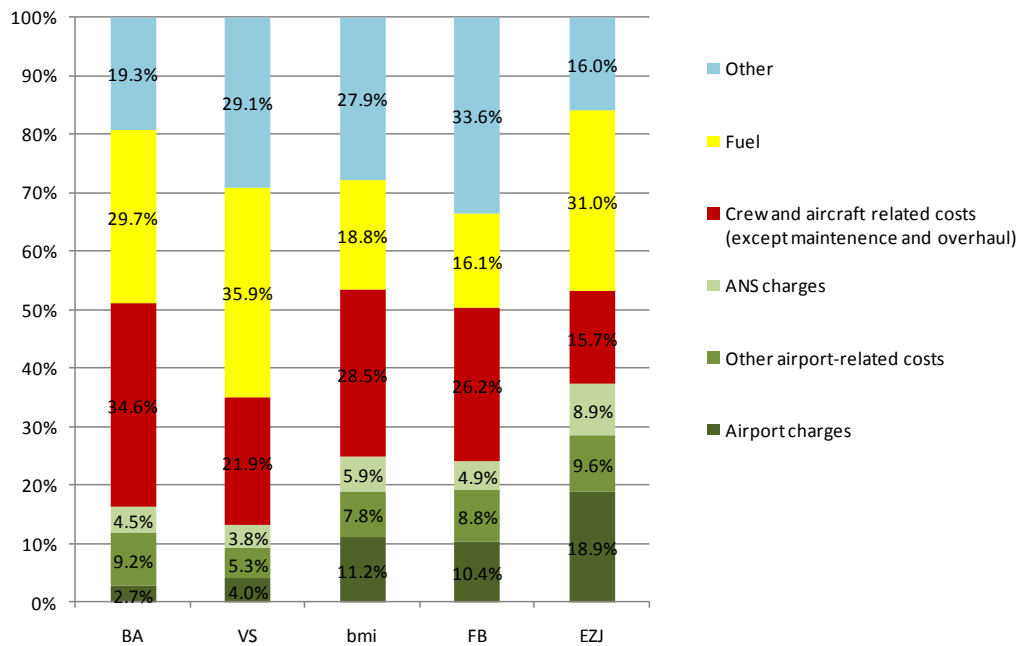
²⁰ As at 30 September: 167 A319s, 35 A320s, and 2 Boeing 737-700s (easyJet Annual Report 2011)

that most mid-sized airports would be appropriate substitutes to Stansted in terms of the product offering.²¹

2.69 Turning to the impact of an increase in airport charges on the airlines operating at Stansted, airport charges are generally a much higher proportion of LCC's costs than they are for FCCs, and for those operating network and long-haul services (such as BA, BMI and Virgin). As a result, the airlines at Stansted are likely to be more sensitive to an increase in airport charges than many of the airlines operating at Gatwick or Heathrow.

2.70 Figure 3 shows the share of operating costs accounted for by airport-related costs for the major UK airlines. It illustrates that these costs constitute about 10 per cent for BA and Virgin ('VS'), which is representative of network/long haul based carriers, and about 20 per cent for bmi and Flybe ('FB'), which is representative for carriers with a more regional focus and smaller aircraft, albeit that BMI has a mix of regional, short-haul and mid-haul operations. In contrast, airport-related costs account for about 30 per cent for easyJet, an LCC.²²

Figure 3 Shares of operating costs of major UK airlines



Source: CAA airline account information, latest available financial years²³

2.71 Figure 4 shows a summary of easyJet operating costs, which highlights the importance of costs relating to ground operations (£14.79 per seat flown), which represents 45 per cent of total operating costs (excluding fuel). This

²¹ Ryanair currently operates from 160 airports, with 47 bases. easyJet currently operates from 123 airports, with 19 bases.

²² This analysis has been taken from the CAA's airline statistics, which only cover airlines registered in the UK.

²³ Figures taken from Table 6 of the 2009/10 airline accounts published regularly on the CAA's website: <http://www.caa.co.uk/default.aspx?catid=80&pagetype=88&pageid=13&sglid=13>. Airport-related costs for the purpose of this figure include the following line items: 22, 24, 25, 27. This is likely to include also costs for services that fall outside the services relevant for this assessment, for example for ground handling services. Costs charged for relevant services provided by airport operators are therefore likely to constitute a lower share.

compares to the current airport charges at Stansted, which are equivalent to £7.26 per passenger for 2012/13.²⁴

Figure 4 easyJet operating costs (excluding fuel)

Operating costs excluding fuel						
Underlying costs *	2011			2010		
	£ million	£ per seat	Pence per ASK	£ million	£ per seat	Pence per ASK
Ground operations	923	14.79	1.33	805	14.36	1.28
Crew	407	6.51	0.58	336	6.00	0.53
Navigation	285	4.56	0.41	256	4.57	0.41
Maintenance	179	2.86	0.26	177	3.16	0.28
Selling and marketing	102	1.64	0.15	92	1.64	0.14
Other costs	171	2.74	0.25	186	3.31	0.30
	2,067	33.10	2.98	1,852	33.04	2.94

Source: easyJet Annual Report, 2011

- 2.72 The airlines operating at Stansted are able to use a large number of other airports – in operational terms – and have cost structures that mean that they are more sensitive to increases in airport charges. In addition, the airlines at Stansted typically make relatively limited investments in facilities at the airport, particularly when compared to the investments made by full-service and network carriers. Indeed, both Ryanair and easyJet stress the flexible nature of their operations.^{25,26}
- 2.73 It appears that the costs involved in switching from one airport to another in terms of the physical move would be limited. It should be noted, that in terms of market definition and market power assessments, we only need to consider a switch at the margin, i.e. it would not be necessary for Ryanair to switch its whole operation at Stansted (which may be considerably more costly) to another airport, but just a share of its business.
- 2.74 Consequently, the main barrier to switching is the ability to operate a profitable route out of an alternative airport and the impact that switching a route from Stansted to the next-best airport might have on the yields earned by the airline. This is discussed further in chapter 3.
- 2.75 For the purposes of the product market definition, this supports the view that the airlines at Stansted operate in a broad market, and have the flexibility to use a large number of airports, albeit that there are a small number of commercial airports where the infrastructure does not support their operations, due to the capability of the runways. The operational characteristics of Heathrow, with its congestion, relatively low levels of punctuality and longer taxiing and airspace delays, suggests that this airport is unlikely to be a viable alternative for the airlines currently at Stansted.

²⁴ 'BAA Stansted Airport Charges – April 2012-March 2013', BAA

²⁵ See, for example, interview with Michael O'Leary, retrieved from www.anna.aero, quoted in footnote 75.

²⁶ "easyJet has built flexibility into its fleet planning arrangements such that it can increase or decrease capacity deployed, subject to the opportunities available and prevailing economic conditions. The Company also has flexibility to move aircraft between routes and markets to improve ROCE.", easyJet Annual Report (pg 11), 2011.

Summary: product market – passenger airlines

- 2.76 In summary, the product market definition for Stansted from the perspective of airlines appears to include any mid-sized airport (or larger) with an appropriate runway. However, airlines use airports in order to gain access to passengers and require access to a catchment that is sufficiently large and affluent to support the profitable operation of services. This narrows the set of airports that might be included in the product market, to include only those airports that provide access to a relatively large pool of demand, as an airline would not be able to switch to an airport with a poor catchment even if it had the appropriate infrastructure to operate there. This interplay between passengers and airlines is discussed further in the final section of this chapter.
- 2.77 There may be a case for distinguishing between the supply of infrastructure and infrastructure services to based and inbound aircraft, reflecting the different demand conditions throughout the day, the uncertainty surrounding the ability to switch between based and inbound, and the ability of the airport to vary its charges between these two aircraft types. This issue appears particularly important in the context of the overall assessment of Stansted, and is considered further below in the context of whether a distinction can be made between peak and off-peak capacity. Reflecting the current balance of evidence, the CAA has not yet taken a firm view on this aspect of the market definition for Stansted.

Temporal markets

- 2.78 The previous section focused on how the differing airline infrastructure requirements, might inform the relevant product market for the assessment of Stansted. This section further considers whether there is evidence to support a narrowing of the product market for Stansted, to distinguish between the services supplied to airlines flying at different times of day.
- 2.79 The nature of the capacity available at Stansted means that, in operational terms, it is highly substitutable between different aircraft types. The runways and taxiways are, for example, capable of handling the largest passenger aircraft currently operating. This means that there are few physical limitations to the ability of airlines to redeploy their slots between services at different times.
- 2.80 However, there are commercial and operational constraints that mean that certain services at certain times of day are more popular for airlines. In particular, based airlines at Stansted tend to place particular value on the early morning slots, in order to deliver a sufficient number of rotations to deliver high aircraft utilisation, and to make a route profitable.
- 2.81 This may imply separate markets for the provision of peak and off-peak slots since airlines currently using morning peak slots could not easily switch to off-peak slots. Although Stansted does not currently price differentiate by time of day, other airports do and there are no legal barriers to such a charging structure. The need to distinguish between peak and off-peak (and adopt a narrower product market definition) will, therefore, depend upon the ability of

airlines to reduce their use of peak capacity in response to price, either by switching to off-peak periods, or to other airports.

- 2.82 This issue of the flexibility of airlines at peak is important to the overall assessment of Stansted's market power. The CAA has not been able to reach a definitive view on the issue, and so we leave this aspect of the market definition open at this stage. This issue is discussed in more detail in chapter 3.

Cargo carriers

- 2.83 While Stansted's passenger airline customers do not generally carry bellyhold cargo, 6.8 per cent of Stansted's flights are cargo-only flights, making the airport the UK's second largest for cargo-only flights, with an 18 per cent share of UK cargo-only flights. Stansted's cargo customers are predominantly freighter carriers and less than 1% is carried bellyhold. Table 1 shows Stansted's main cargo customers.

Table 1 Stansted's cargo customer shares of freighter cargo

FEDERAL EXPRESS CORP	37%
BRITISH AIRWAYS PLC	24%
UNITED PARCEL SERVICE CO	14%
TITAN AIRWAYS LTD	6%
JET2.COM LTD	6%
ABX AIR INC	3%
ASIANA AIRLINES	3%
Other	6%

Source: CAA Airport Stats 2010

- 2.84 As for passenger airlines, the choice set for cargo carriers will be limited by their infrastructure and service requirements, and the relevant product market will be affected by their responsiveness to price changes. In this respect, the infrastructure requirements of cargo-only flights are likely to affect the choice set of these airlines, as these services have particular runway and groundhandling requirements, as well as the need to access appropriate surface access.
- 2.85 In respect of the product market, there are a number of airports in the UK that are capable of accepting cargo-only services, albeit that some impose operational restrictions on the aircraft that can be used. For example, there are significant cargo-only operations at East Midlands, Manston, Robin Hood, Manchester, and a number of other UK airports. As some cargo operations typically use large aircraft, notably Boeing 747s, the infrastructure requirements are likely to narrow the product market somewhat. In addition, the limitations imposed by airports under the Traffic Distribution Rules mean that there cannot currently be an increase in the cargo-only services at Heathrow, effectively removing this airport from those that can compete with Stansted for cargo-only aircraft.²⁷

²⁷ Heathrow will compete, to some degree, with these cargo-only flights, as it is the UK's largest cargo airport, with the majority of its cargo being carried as bellyhold.

Provision of infrastructure and access to third-party suppliers

2.86 As noted above, there are a number of services that are provided by third-parties, under contract to airlines, such as groundhandling services, fuel providers, catering and maintenance. In addition, there are a number of services provided by third parties to passengers, such as retail and catering. The airport provides access and terminal space to these third parties. The airport also typically controls the overall retail offering within the terminal, often with a revenue-sharing arrangement.

Suppliers to airlines

2.87 Access to Stansted for these airline suppliers is crucial to the airlines' operations, with all possible substitutes at the airport requiring access to the terminal and apron facilities. For this reason, we consider that the product supplied by the airport to airlines includes the provision of access to third party suppliers. Further, any market power enjoyed by virtue of the runway, apron and terminal infrastructure would also be enjoyed in respect of providing access to these third-party suppliers.

Suppliers to passengers

2.88 In respect of suppliers of passengers, it is useful to distinguish between retail services that are related to the passage of passengers through the airport, where passengers may have low levels of discretion as to whether they might make a purchase, and those where purchases are highly discretionary.

2.89 For those services where most passengers will have a choice as to whether to consume the product or service – such as fashion and electronics – we have identified no reason to suggest that passengers would be any less sensitive to the price and service offering than they would be in other retail environments. Further, the suppliers of these goods and services will generally have other options to providing their services at Stansted, since they are part of wider retail markets. It is unlikely, therefore, that Stansted would be able to profitably raise prices to these suppliers, or for the suppliers to raise prices to passengers, above the competitive level²⁸. Consequently, we do consider them again in this paper.

2.90 Turning to those services that are less discretionary – which might include the provision of food and drink, and travel essentials, such as bureau de change – it is possible that a significant proportion of passengers have somewhat limited options as to whether or not to purchase these services. This will vary depending upon the individual service being considered. For example, given the waiting times that can be involved in air travel, and security restrictions, many passengers may face little choice but to purchase some food and drink. In such circumstances, the airport could limit the space available to particular retail offerings, and/or limit competition between different suppliers, and in doing so put upward pressure on prices to passengers and rental payments to the airport (including any revenue sharing arrangements).

²⁸ The locational characteristics of airports, with their consistent and high footfall might, however, justify a premium on retail rents over some other retail environments.

- 2.91 It appears, therefore, that if the airport enjoys a position of substantial market power over the provision of aeronautical infrastructure, it might also enjoy a similar position in respect of some retail activities.

Supply-side substitutability

- 2.92 The CAA has adopted the OFT's view that "supply-side substitution can be thought of as a special case of entry – entry that occurs quickly, effectively and without the need for substantial sunk investment."²⁹
- 2.93 Airports that are able to quickly begin providing the same infrastructure and service as other airports in the relevant product market can be included within that relevant product market.
- 2.94 However, given the investment and timescales needed to upgrade an airport's facilities, it is unlikely that we would consider this kind of supply-side substitution quick and effective enough for this type of airport to be considered in the relevant market. Instead we will consider them as constraints through potential entry.

Geographic market definition

- 2.95 The previous section considered the types of airports that are likely to be included in the same product market definition as Stansted. However, in order to understand which airports compete with Stansted for its customers, we must also consider the geographic market in which it operates. The geographic market will be affected by the airports that each type of user considers to be reasonable alternatives to using Stansted.
- 2.96 Reflecting this, to reach a view on the geographic market for Stansted, the remainder of this section considers the ability of each type of user to relocate to alternative airports. As with the product market definition, in the following section, we look at the choice set available to each of Stansted's different user groups (and if relevant, subgroups) on a geographic dimension and their ability to switch between the different alternatives. We also assess the potential for these users to react to an increase in charges by the airport.
- 2.97 We have then suggested geographic market definitions reflecting the alternatives that each type of user – passengers, passenger airlines and cargo airlines – can readily switch between.

Passengers

- 2.98 In past cases, competition authorities have considered that the geographic market for passengers extends to include at least the south east of England. This is same geographic scope for the market defined by the Office of Fair Trading (OFT) in the context of the BAA airports market investigation, while the Competition Commission left it open³⁰. We have found that the available

²⁹ Para 3.56 of the CAA's guidelines

³⁰ OFT and CC paper refs http://www.offt.gov.uk/shared_offt/reports/transport/oft882.pdf

evidence tends to support a market for passengers that includes at least the south east of England.³¹

2.99 The ability of passengers to switch to different airports will vary depending on whether a passenger is inbound or outbound, their journey purpose and their destination. This implies that the area over which the airport attracts passengers may vary by passenger type.

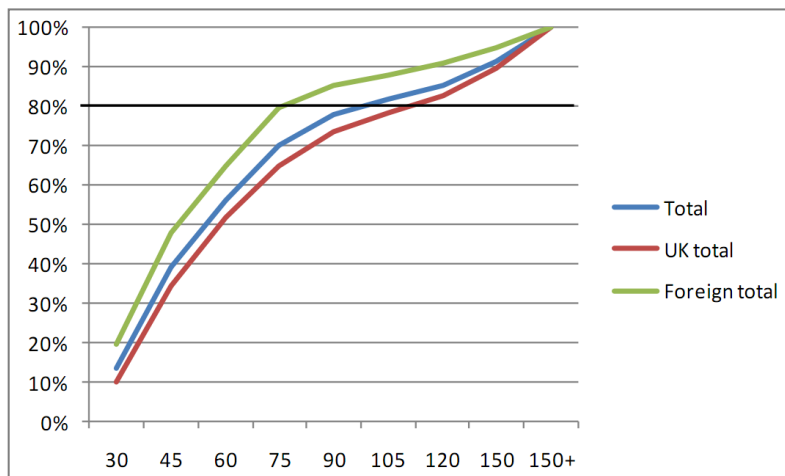
2.100 The following sections look at the different passenger types and considers whether there is any impact on geographic market definition resulting from different passenger characteristics.

UK resident vs. non-UK resident

2.101 Whether a passenger is resident in the UK or outside of the UK may affect the choice set available to them on a geographic level. Figure 5 considers the impact that residence has on passengers' average journey times to and from the four major London airports. As discussed in the CAA's working paper on catchment areas³², throughout this section we have focused on the travel times accepted by 80 per cent of passengers.³³

2.102 It shows that UK resident passengers are more likely to travel further to reach an airport, compared to those residing overseas. Further, the analysis of Stansted passengers reveals that foreign residents travel between 60 and 75 minutes to/from the airport, compared to between 90 and 120 minutes for UK residents.³⁴

Figure 5 Surface travel time according to residence (4 major London airports)



Source: CAA analysis of the CAA passenger survey 2010 and DfT surface access data

2.103 These differences based on residence could reflect a number of factors, including the potential greater awareness of alternative airports by UK residents, and the tendency for a larger proportion of foreign residents to be

³¹ For clarity, we refer here to a broad geographic area of England, which includes Greater London, East Anglia and the 'home counties'. This should be distinguished from the South East planning region, which does not include Greater London.

³² 'Catchment area analysis – working paper', CAA, October 2011

³³ We note that this is a benchmark that has been adopted by other competition authorities, such as the Competition Commission in its analysis of supermarkets.

³⁴ See 'Catchment Area Analysis – Working Paper', CAA, October 2011 (Annex). Figures quoted are the travel times that relate to the 80th percentile of passengers.

travelling to major cities, notably to London, whereas the point of origin of UK residents is more distributed.

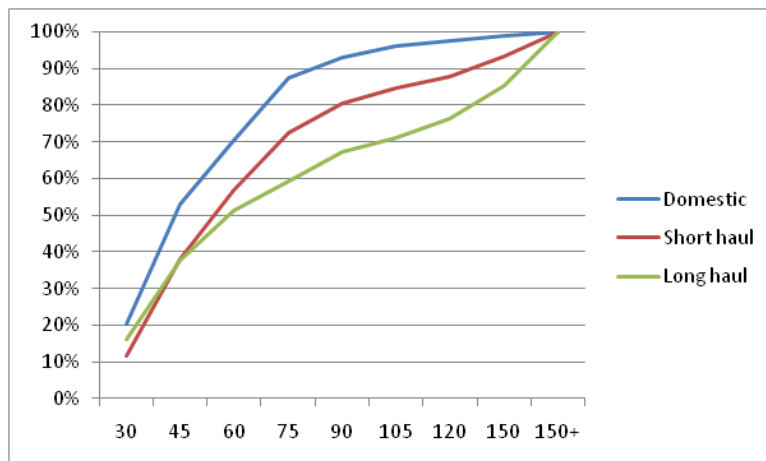
- 2.104 However, there may be other important differences between UK residents and foreign residents. For example, UK residents travelling outbound will only be able to switch to other nearby airports, irrespective of their choice of destination. In contrast, a foreign resident travelling inbound to the UK might be able to vary their destination and travel to an alternative airport located in a different town or country as well as to other nearby airports. This ability might be offset somewhat by the lower level of awareness of alternative UK airports.
- 2.105 However, as the airport does not contract directly with passengers, it is unlikely to be able to distinguish between passengers on the basis of residence. Further, as discussed above, the airport is unlikely to be able to successfully differentiate between inbound and outbound passengers, as the majority of passengers travel back to their original departure airport, which means that any variation of charges between inbound and outbound has a common effect on the passenger's overall trip cost.³⁵
- 2.106 It is possible, however, that the airport could vary other charges in ways that indirectly affect UK and foreign (or inbound/outbound) passengers differently, such as through car parking charges (which are more likely to affect UK resident/outbound passengers).
- 2.107 Overall, we do not consider that there is sufficient evidence to distinguish between UK and foreign (or inbound/outbound) passengers for the purposes of this assessment.

Short-haul vs. long-haul

- 2.108 The willingness to travel to use an airport can vary depending upon the passengers' destination. Figure 6 below shows that the surface travel time for domestic passengers is less than that of short-haul passengers, which is less than that of long-haul passengers. This pattern might be explained by the larger proportion of domestic and short-haul passengers' overall journey time that would be accounted for by surface travel, when compared to long-haul services. The greater availability – and higher level of route overlaps – of domestic and short-haul services might be a further explanatory factor, as long-haul passengers are more likely to have to accept longer surface access journeys in order to reach certain long-haul destinations.

³⁵ An airline may be able to distinguish in these ways, and may choose to pass through an increase in airport charges disproportionately to the less price elastic passengers. We examine the relevance of this in the final section of this chapter.

Figure 6 Surface travel time according to flight duration (4 major London airports)



Source: CAA analysis of the CAA Passenger Survey 2010 and DfT surface access data

2.109 For the purposes of defining the geographic market of Stansted, and reflecting the large proportion of passengers that travel on short-haul services, this analysis suggests that a large number of passengers are willing to accept journey times of up to 90 minutes to reach an airport. However, the average journey times for some short-haul passengers are much higher than the figures shown above (which relate to all four major London airports). For Stansted, UK resident short-haul passengers travel between 90 and 120 minutes to reach the airport, whilst foreign residents travel around 75 minutes to reach the airport.³⁶

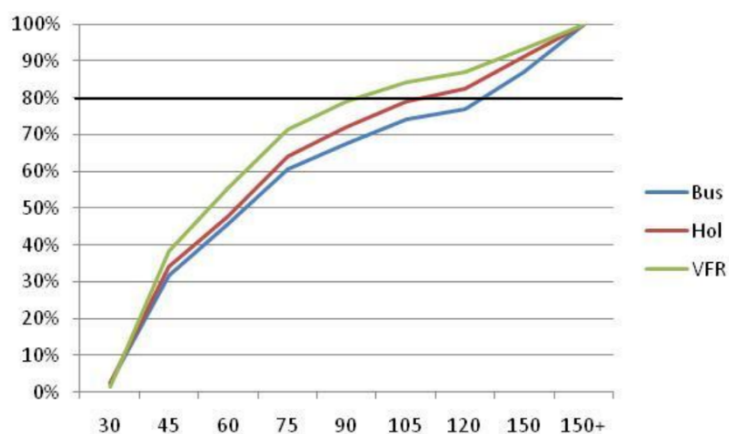
2.110 Whilst Stansted might not have any significant long-haul operations, to the extent that the airport competes to attract long haul passengers to the airport in the future (and attract airlines to operate these services), it is likely to compete for passengers over a relatively broad geographic area, reflecting the tendency for long-haul passengers to be willing to accept longer surface access journey times than those travelling on domestic or short-haul services.

Journey purpose

2.111 Figure 7 below shows the surface travel time for UK residents at Stansted travelling short-haul, distinguishing between business, holiday and VFR. It shows that VFR passengers travelling for around 90 minutes to reach the airport, less than holiday or business travellers.

³⁶ See Figure A. 17, 'Catchment Area Analysis – Working Paper', CAA, October 2011.

Figure 7 Surface travel time for UK residents at Stansted



Source: CAA analysis of the CAA Passenger Survey 2010 and DfT surface access data

2.112 This pattern is somewhat different at Stansted than at the other London airports, where holiday passengers on average travel further to reach an airport than business or VFR passengers.³⁷ One potential explanation, cited in the CAA's *Catchment Area Analysis* working paper, is that the business passengers may be travelling to Stansted to fly on one of the large number of services that are only offered from the airport. The lower average surface travel times for VFR passengers could also be explained by the concentration of these passengers' point of origin in Greater London and, in particular, central, north and east London.

2.113 In light of the mixed evidence on average travel times, and the practical difficulties associated with the airport distinguishing between passengers on the basis of their journey purpose, it does not appear to be appropriate to define different geographic markets based on journey purpose. Instead, the average surface access times of 90 to 105 minutes appear to be appropriate.

Passenger preferences

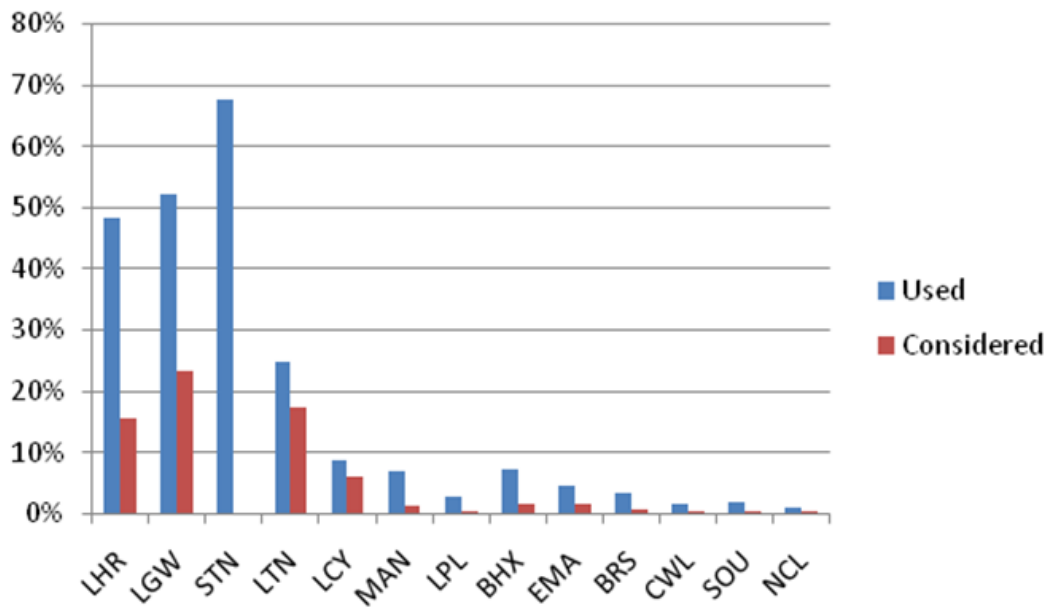
2.114 The CAA working paper on passenger survey results published in November looked at which airports passengers considered using or had used in the past, their reasons for choosing the airport and their responsiveness to a change in price.³⁸

2.115 Figure 8 shows the airports previously used in the past two years and airports considered as alternatives for the current flight by short haul passengers at Stansted. It shows that the airports that the passengers at Stansted had previously used and considered were, perhaps unsurprisingly, Heathrow, Gatwick and Luton. London City, Manchester and Birmingham were also previously used by at least five per cent of passengers. This supports the view that the geographic market for passengers is at least as wide as greater London.

³⁷ See Figure 10, 'Catchment Area Analysis – Working Paper', CAA, October 2011.

³⁸ 'Passengers' airport preferences: results from the CAA Passenger Survey', CAA, November 2011

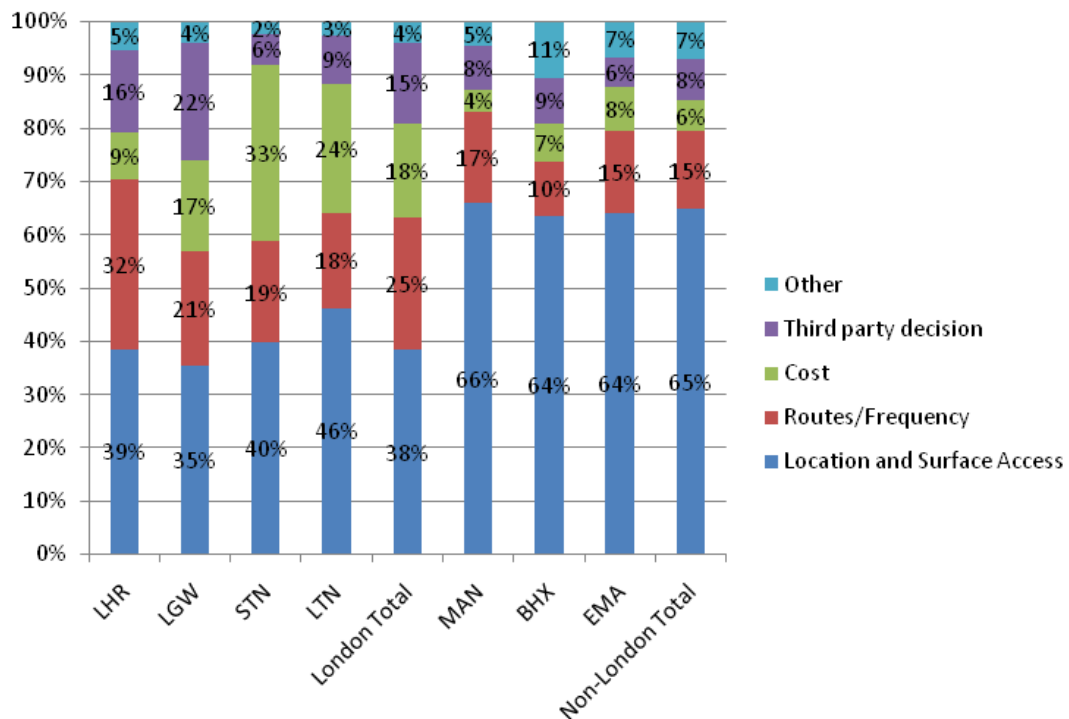
Figure 8 Airports previously used in the past two years and airports considered as alternatives for current flight by short haul passengers at Stansted



Source: CAA analysis of CAA Passenger Survey data – supplementary stated preference question

2.116 Figure 9 below shows that the three main reasons for airport choice at Stansted were location and surface access, cost and routes and frequency, with the most popular being location and surface access.

Figure 9 Reasons for airport choice



Source: CAA analysis of CAA Passenger Survey data (January to July 2011 provisional)

2.117 These results imply that when passengers are choosing an airport, the airport's facilities and services are not particularly important factors.³⁹ Instead, the results suggest that flight availability, cost and the journey time to reach an alternative airport are particularly important factors, which are also likely to affect passenger switching costs.

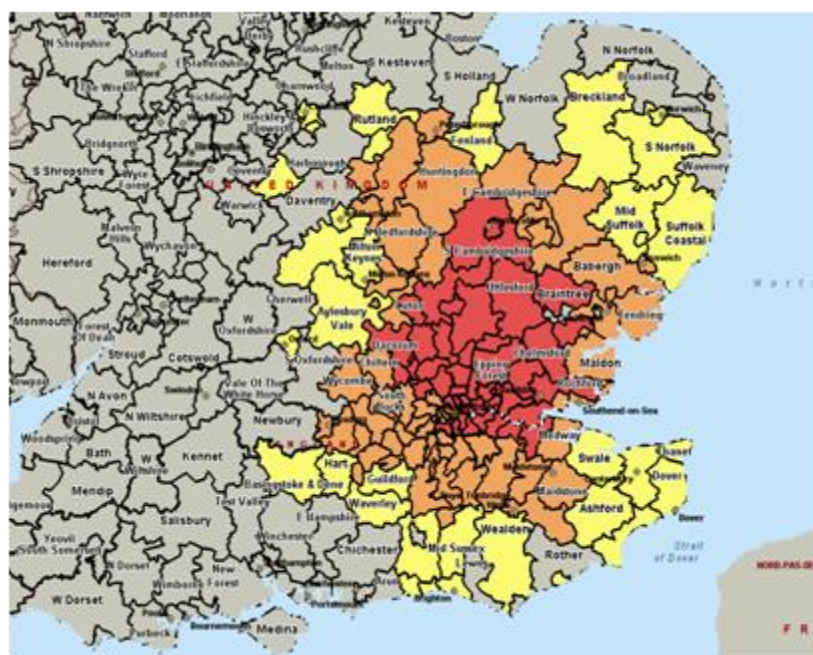
2.118 In terms of informing the geographic market definition (and the market power assessment), these results are consistent with an approach that considers measures of surface access journey times, route overlaps and cost.

Catchment area analysis

2.119 A common approach to defining the geographic markets of airports is to look at catchment areas. The evidence in the CAA's working paper on catchment area analysis suggests that the geographic market for Stansted covers at least the South East of England (including Greater London), perhaps also extending to include the East of England.

2.120 Figure 10 shows the 60, 90 and 120 minute travel time isochrones around Stansted. It shows that within 90 minutes, it is possible to travel across London or north as far as north Cambridgeshire.

Figure 10 60, 90 and 120 minute surface access travel times for Stansted

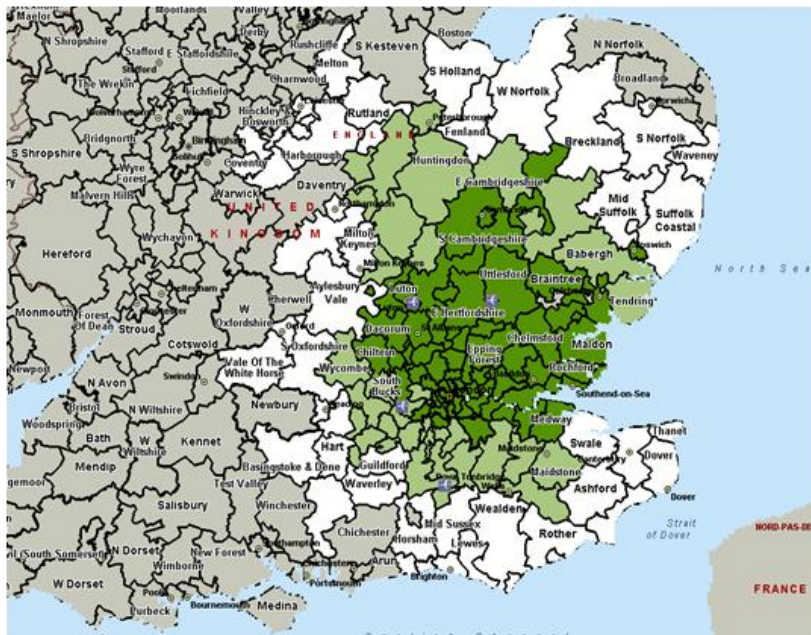


Source: CAA analysis of DfT surface access data
Red: 60 minutes; Orange: 90 minutes; Yellow: 120 minutes

2.121 Figure 11 illustrates the actual time travelled by passengers at Stansted. Pale green and dark green shows the area covered using the travel time within which 80 per cent of passengers travelled. It is very similar to the chart above, reflecting the fact that 80 per cent of Stansted's passengers travel 90 minutes or less to reach the airport.

³⁹ The passenger survey included a number of potential responses relating to airport facilities and services. These responses, together with a number relating to airline factors, are grouped within 'other' in the figure.

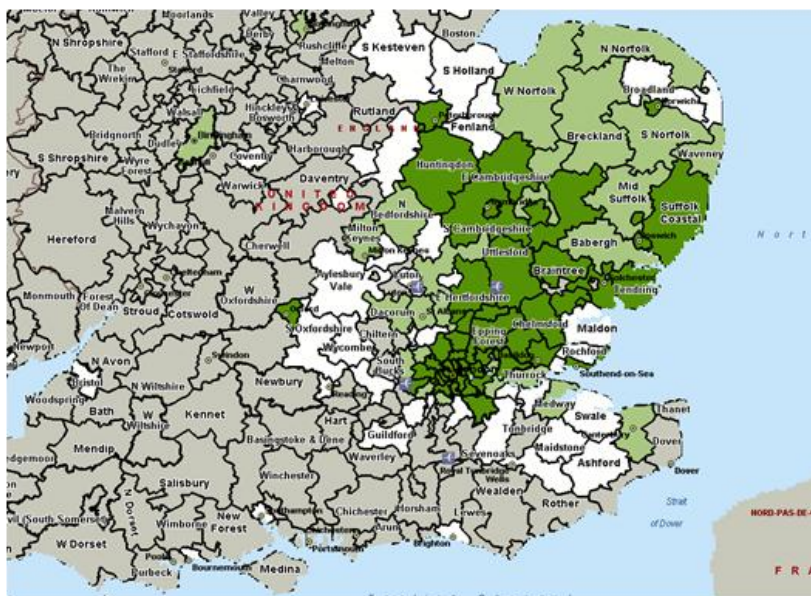
Figure 11 Stansted actual surface travel time catchment area



Source: CAA analysis of the CAA Passenger Survey 2010 and DfT surface access data
 Dark green – 70%; Light green – 80%; White – 90% of passengers

2.122 Lastly, Figure 12 shows the historical actual usage by passengers of Stansted. This was compiled by listing each district in passenger number order. Those districts encompassing the first 70 per cent of passengers are shaded dark green, those encompassing the next 10 per cent (from 70 to 80) are shaded pale green and the districts encompassing the next 10 per cent (from 80 to 90) are shaded white.

Figure 12 Stansted historical actual usage catchment area



Source: CAA analysis of the CAA Passenger Survey (2010)

2.123 This figure highlights that Stansted has drawn passengers from the Greater London area, the area of the South East that is north of London and much of the East of England. The fact that it does not appear to draw strongly from south or west of Greater London is likely to reflect the additional travel time

involved in travelling through or around London, and that passengers would – other things being equal – prefer to travel to their closest airport.

Catchment area overlaps and the geographic market

2.124 It should be noted that the geographic market is not defined by the catchment area of an airport, as this shows the current pattern of passengers' use of an airport, rather than describing the geographic area from which the most important competitive constraints arise. A geographic market can, therefore, include a broader area, to the extent that airports attracting passengers over these areas impose important competitive constraints on the airport being assessed. Further, a narrow catchment area (based on historical usage) could be a product of active competition from neighbouring airports for the passengers originating nearby the airport being assessed.

2.125 It should be noted that there are significant overlaps between the catchment areas of Stansted and all of the major London airports, as they all draw a significant proportion of their passengers from the Greater London area. Indeed, the CAA's Catchment Area working paper considered the strength of overlaps with the other London airports.

2.126 The results of this analysis are reproduced in Table 2 below. This table treats a district as being in a catchment if it contributes to the nearest (by surface travel time) 80 per cent of passengers using an airport. Districts can, therefore be in the catchment of multiple airports. For each type of overlap, the table shows the number of districts, the total number of passengers originating from that overlap area (across the four airports), the passengers using Stansted – both in terms of absolute numbers and proportions of the total – and, in the final column – Stansted's share of passengers originating in each of the overlap areas. More information is set out in the CAA's *Catchment Area Analysis Working Paper*.

Table 2 Overlaps in Stansted's surface travel time catchment area

Overlaps	#Districts	4 Airport Pax	STN Pax	Proportion (4 APTS)	Proportion (STN)	STN Share
STN/	7	1,628,104	816,476	2%	5%	50%
LHR/STN/	2	760,058	358,846	1%	2%	47%
STN/LTN/	4	730,548	311,469	1%	2%	43%
LHR/LGW/STN/	6	1,909,550	208,020	2%	1%	11%
LHR/STN/LTN/	5	2,514,984	894,836	3%	5%	36%
LHR/LGW/STN/LTN/	73	56,919,885	10,948,193	60%	64%	19%
Total STN Catchment	97	64,463,130	13,537,842	68%	79%	21%
Out of Catchment		30,565,726	3,651,545	32%	21%	12%
Total		95,028,855	17,189,387	100%	100%	18%

Source: CAA analysis of the CAA Passenger Survey 2010 and DfT surface access data

2.127 This analysis highlights the strength of overlaps with the other London airports, with 64 per cent of Stansted's passengers originating from (travelling to) a district that falls within the catchment area of all three of Heathrow, Gatwick and Stansted. Only 5 per cent of Stansted's passengers originate in a district that does not fall within the catchment areas of at least one of these airports. In addition to these airports, the catchment area of Stansted

suggests that the airport interacts significantly with both Norwich and Southend airports.

- 2.128 In this context, we also note that the results of the modelling undertaken by Frontier (for easyJet) using the DfT passenger allocation model, suggests that passengers responding to price increases at Stansted relocate to Gatwick (around 40 per cent of those switching), Heathrow (20 per cent) and Luton (16 per cent), with some significant switching to non-London airports (14 per cent).⁴⁰ This modelling is discussed in more detail in chapter 3.
- 2.129 This supports the view that the relevant geographic market covers much of the south east of England, including Greater London and a number of districts falling in the East Anglia planning region.

Summary: Passengers – Geographic Market

- 2.130 In summary, there does not appear to be any reason to distinguish between different geographic markets by passenger types at Stansted.
- 2.131 Passenger survey evidence suggests that most passengers using Stansted would be willing to travel up to 90 minutes to use an airport. In combination with catchment overlap evidence, this would suggest that Stansted's catchment covers the South East of England, and includes Greater London.
- 2.132 In addition, historical usage shows that Stansted draws a significant number of passengers from the East of England, implying that the geographic market for Stansted passengers should be broadened to include a number of districts in the East of England.

Passenger airlines

- 2.133 To form a view on the relevant geographic market for the provision of infrastructure and infrastructure services to passenger airlines, it is useful to consider the airports to which the airlines using Stansted could switch a significant proportion of their business in light of a price rise.
- 2.134 The ability for airlines to switch between different airports on a geographic dimension will depend, to some extent, on the airline's business model, destinations and whether the aircraft or based at the airport or operates inbound.
- 2.135 As discussed above, Stansted predominantly serves LCCs, operating short-haul, point-to-point services. The business model of these airlines tends to involve basing aircraft at airports of different sizes across Europe from which they offer point-to-point services. As discussed above, airport charges are also typically a higher proportion of their overall cost base than other carriers, suggesting a higher degree of responsiveness to a given price change.
- 2.136 Furthermore, we have already highlighted that the largest airlines at Stansted have a relatively large number of existing bases across Europe, and a large number of airports to which they already operate:

⁴⁰ See <http://www.caa.co.uk/docs/5/Frontier%20pre-Market%20power%20assessment%2006122011.pdf> for the results of this modelling. Percentages are based on the unrestricted modelling for Stansted, comparing the modelled increases at other airports to the decrease at Stansted.

- Ryanair operates from 160 airports, with 47 bases; and
 - easyJet operates from 123 airports, with 19 bases.
- 2.137 This characteristic will tend to reduce the costs associated with moving capacity away from Stansted, albeit – as noted above – that doing so might result in a reduction in the revenues earned by the airlines.
- 2.138 These airlines, and other no frills operators, also have a track record of moving services between different airports, cancelling under-performing routes and moving their growth across a number of different European markets. Given that they already have bases across Europe, it should be easier for them to switch aircraft between bases than it would be for a network carrier to relocate to a new base.
- 2.139 In addition, a number of the services at Stansted operate on an ‘inbound’ basis, with their first service arriving at the airport, rather than being based at the airport overnight. These services are likely to be particularly flexible and responsive to prices at Stansted, as the costs of moving services between two destination airports are likely to be somewhat lower than the costs involved in moving an aircraft between different bases.⁴¹
- 2.140 At present, whilst a significant number of services at Stansted operate ‘inbound’, the majority operate on an ‘outbound’ basis. These inbound services are, however, still significant in the context of understanding the responsiveness of the most marginal services – i.e. those most likely to discipline the airport’s conduct.
- 2.141 There may also be a number of other services where the switching costs involved are particularly low, such as switching of services between airports in the southeast of England, where the major airlines already have a significant presence. In such circumstances, switching capacity between airports is more likely to result in passengers also switching with the airline, and would tend to involve lower marketing costs than switching that involves launching a service that is new to a region.
- 2.142 This suggests that there is a relative hierarchy in terms of the services that are most likely to be marginal, and the most responsive to price changes. Services that can be relocated to alternative London airports are likely to incur particularly low switching costs, whilst moving inbound services from Stansted to other airports where the airlines have an existing presence are also likely to have relatively moderate switching costs. Beyond this, relocating aircraft based at Stansted to another base is likely to result in higher switching costs, albeit that the larger airlines at Stansted emphasise that their business models are designed to be flexible.
- 2.143 It appears that, given the business model of airlines at Stansted, and the likely magnitude of switching costs (which are discussed in more detail in chapter 3) that the airports in the Southeast of England are likely to be very close substitutes to Stansted (although Heathrow is likely to fall outside of this

⁴¹ Moving aircraft between bases is more likely to result in costs relating to relocation and/or redundancy of staff, and/or require pilots and cabin crew to be recruited at the alternative base.

market, due to its particular operational characteristics).⁴² Furthermore, it appears that the switching of marginal services is likely to take place over a broader area. In particular, the number and distribution of existing bases of Stansted's two largest customers – and the large number of European airports to which they currently operate – means that the geographic market relating to the airlines at Stansted is likely to be European wide.

- 2.144 However, there are factors that might limit this switching in practice. One of these is the potential for the yields that can be earned at Stansted to act as a barrier to switching, as services moved to other airports may earn a lower yield. This could reflect the particular value that access to the southeast of England (and Greater London, in particular) confers on airlines at Stansted. The CAA has not been able to analyse this issue further at this stage.
- 2.145 On the basis of the evidence currently available, whilst there is a significant degree of uncertainty associated with the magnitude of switching costs relating to the impacts on yields, it seems likely that the airlines at Stansted would be able to switch aircraft relatively easily between bases in response to a 5-10 per cent increase in prices above the competitive price level at Stansted. By switching to existing bases, the risks and costs involved are likely to be smaller.
- 2.146 The issue of switching costs is discussed in more detail in chapter 3, where we also consider the incentives on airlines to switch away from the airport.

Cargo carriers

- 2.147 We have seen mixed evidence on the likely geographic market for Stansted from the perspective of cargo carriers:
- Robin Hood Doncaster referred to the importance of truck driver shift patterns in defining the geographic areas over which an airport competes for cargo carriers. On this basis, they argued that the market was largely UK-wide for most cargo.
 - East Midlands airport also refers to trucking, mentioning the relevance of a four hour truck drive and proximity to bellyhold operations at Heathrow, Birmingham and Manchester as important factors in why cargo carriers should choose EMA.⁴³
 - Manston airport refers to itself as an excellent platform for access to Europe.⁴⁴
- 2.148 The CAA's assessment of the case for de-designating Stansted also referred to confidential information that highlighted the importance of intercontinental cargo flows at Stansted, with a significant proportion of Stansted cargo travelling to Heathrow and then onward to destinations outside of the UK/Europe.
- 2.149 There is currently limited evidence available to the CAA on the extent of the geographic market for cargo carriers at Stansted. However, the evidence that

⁴² This is discussed in the context of the product market.

⁴³ <http://www.eastmidlandsairport.com/emacargo.nsf/Content/WhyEMA>

⁴⁴ <http://www.manstonairport.com/for-business/aviation/freight.html>

is available appears to support the CAA's previous view that the geographic market is likely to be at least national, with aspects that are competing in an intercontinental market.

- 2.150 The time sensitive nature of some cargo might suggest a sub-market for this cargo. We have not received any evidence to date on this point, but invite views from Stakeholders.

Supply-side substitutability

- 2.151 Supply-side substitutability is not relevant to geographic markets in the context of airports since it is not possible for an airport in one geographic market to begin supplying passengers in another geographic market without relocating, opening a new airport or improving surface access. None of which would be possible in a short time frame.

The interdependence of demand from different user groups

- 2.152 Each of Stansted's user groups could be considered as different 'sides' of an airport market; each with its own characteristics and ability to respond to changes in the price and service offered by Stansted.
- 2.153 Indeed, reflecting the linkages between them, it is likely that the reaction of passengers, cargo carriers or airlines to changing prices and/or service quality will precipitate a reaction from the other (interdependent) users. These reactions may then act together to affect the profitability of such a change in price for the airport and, ultimately, determine the extent of the market power enjoyed by the airport.
- 2.154 This section presents a summary of the earlier findings and considers the potential interactions between the passenger-facing and airline-facing sides of the market and how these might influence the definition of the market within which Stansted operates.

The supply of infrastructure to passengers

- 2.155 The relevant product market for assessing Stansted's market power in respect of passengers is likely to cover a range of aeronautical and non-aeronautical services that are required for the reception, processing and boarding of passengers, including the provision of car parking and other surface access to the terminals.
- 2.156 We saw no reason to distinguish between different geographic markets by passenger types at Stansted. Passenger survey evidence suggests that most passengers using Stansted would be willing to travel up to 90 minutes to use an airport. In combination with catchment overlap evidence, this would suggest that Stansted's catchment covers the South East of England. In addition, historical usage shows that Stansted draws a significant number of passengers from the East of England, implying that the geographic market for Stansted passengers should be broadened to include a number of districts in the East of England.

The supply of infrastructure to passenger airlines

- 2.157 Overall, in respect of the supply of services by Stansted to airlines, the relevant product market for this assessment is the provision of infrastructure and infrastructure services, covering a broad range of aeronautical and non-aeronautical activities, including the landing and parking of aircraft. Given the business model of airlines present at Stansted, it is likely that most mid-sized airports would be able to provide the infrastructure and infrastructure services to enable these airlines to operate.
- 2.158 It was noted that there could be a case for adopting a narrower product market – distinguishing between capacity provided at different times of day – as operational and commercial factors mean that based aircraft for airlines at Stansted need to depart early in the morning.
- 2.159 It appears that, given the business model of airlines at Stansted, and the likely magnitude of switching costs (which are discussed in more detail in chapter 2) that the airports in the Southeast of England are likely to be very close substitutes to Stansted (although Heathrow is likely to fall outside of this market, due to its particular operational characteristics).⁴⁵ Furthermore, it appears that the switching of marginal services is likely to take place over a broader area. In particular, the number and distribution of existing bases of Stansted's two largest customers – and the large number of European airports to which they currently operate – the geographic market from the perspective of airlines is likely to be European wide.
- 2.160 There is, however, a significant degree of uncertainty associated with the magnitude of switching costs relating to the impacts on yields.

Combining the passenger and airline-facing markets

- 2.161 This chapter identified a number of areas where airlines and passengers interact making it more difficult to assess the impact of changes in price. In particular, in order for passengers to switch to an alternative airport, an airline must offer the desired route to the passenger. Similarly, in order for an airline to switch to another airport, there must be sufficient demand from passengers at that airport for any routes that they offer.
- 2.162 In particular, whilst there may be relatively low direct costs associated with an airline relocating to another airport, the willingness to do so will be affected by whether there are sufficient passengers at alternative airports and whether airline switching away from Stansted typically involves airlines accepting a lower yield. To the extent that airlines are able to switch to nearby airports and attract many of the same passengers, this may reduce the adverse impact on yields. Similarly, for passengers to view an airport as a reasonable substitute they will need to be able to find a suitable alternative flight, which will often need to be to the same destination. The airlines' ability to switch will, therefore, depend upon passenger decisions, whilst passengers' choices are likely to be affected by those of airlines.

⁴⁵ This is discussed in the context of the product market.

- 2.163 This interdependence can be particularly important where airlines operate networks, with passengers connecting between services, as the addition of services can attract more passengers, which itself encourages airlines to operate additional services. It is also possible that similar virtuous circles exist at smaller airports, with relatively low levels of passenger and/or airline awareness, as new routes can attract new passengers – who are then more familiar with the airport and likely to use it again – which then can be used in marketing to airlines.
- 2.164 Furthermore, airports are unable to identify passenger groups and would therefore find it difficult to price discriminate between them, but where airlines would be able to identify these passenger groups as they collect more detailed information from passengers. Where different passenger groups have varying needs, it may therefore be possible for airlines to discriminate between them.
- 2.165 These varying needs are likely to make some passenger groups more or less price sensitive than others. This implies that, when an airport raises its charges to an airline, the airline may pass that increase on disproportionately to different passenger groups. The ability to price discriminate in this way may mean that passenger volume losses as a result of price increases are less than if the increase was passed on uniformly.
- 2.166 As Stansted does not currently serve network airlines and is a relatively large and well-established airport – indeed, survey evidence confirms a high awareness of the airport amongst passengers – we have not identified any significant airline-passenger interactions that significantly affect the market power enjoyed by the airport. However, the retail revenues generated from passengers are likely to have a significant impact on the airport's incentives to raise prices to airlines, due to the adverse impact that lower passenger numbers have on profitability. The potential for passenger and airline growth to support each other – and create a form of virtuous circle – could also be relevant to the consideration of the potential for growth in long-haul services at the airport.

3. Factors contributing to Stansted's market position

Introduction

- 3.1 This chapter considers the factors contributing to Stansted's market position, which is then used to support the CAA's overall assessment of the degree of market power enjoyed by the airport.
- 3.2 The previous chapter considered the markets in which Stansted operates, with regard to its various user groups, with a particular focus on passenger airlines, passengers, and cargo carriers. This analysis highlights the importance of understanding how passenger and airline choices affect the market power enjoyed by the airport, including how these two customer groups might interact to discipline (or not) the airport's conduct.
- 3.3 This chapter considers the evidence available on the strength of competitive constraints faced by Stansted. In line with the CAA's *Guidance on the assessment of airport market power*⁴⁶, we will be considering the cumulative impact of competitive constraints arising from within and outside of the markets set out in the previous chapter.

Structure of this chapter

- 3.4 This chapter is structured in a number of sections, starting with a description of the size of Stansted in its markets. This is then followed by three sections focusing on the potential impact of customer switching on the airport's incentives; looking at airline switching, passenger switching and how these two forms of switching interact.
- 3.5 This is then followed by sections that discuss buyer power, entry and expansion, the impact of capacity constraints, and that consider the relevance of evidence on the airport's pricing and behaviour. There is also a consideration of the impact of cargo operations on the airport's market position.
- 3.6 The final section provides a summary and considers how circumstances might change over time, and affect the airport's market power going forward.

Market shares

- 3.7 Depending on how the market for Stansted is defined, its market shares will vary. As shown in Chapter 2, the product and geographic markets for Stansted vary depending on the user group being considered. This analysis focuses on the market shares of Stansted compared to the London-area airports. This reflects the availability of data, notably the survey data (which is only available for a subset of UK airports). The results set out below will, therefore, tend to overstate Stansted's share of the geographic markets set out in Chapter 2.

From the passenger perspective

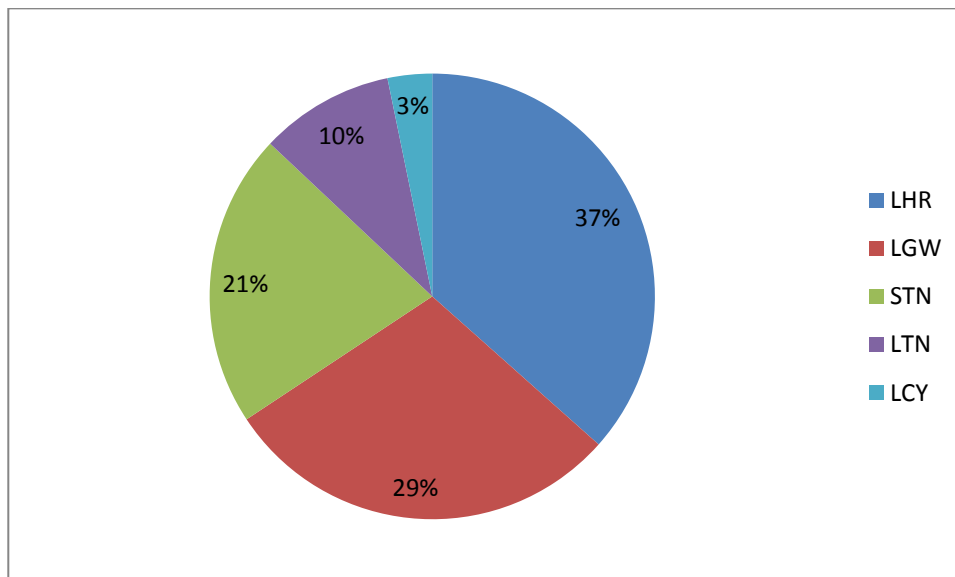
- 3.8 On the evidence currently available, the market definition for Stansted from the passenger perspective appears to be airports in the south east and east

⁴⁶ CAA, 2011, *op. cit.*

of England offering flights to appropriate destinations. We concluded that there was no compelling evidence to define the product and geographic markets further by passenger type.

- 3.9 Figure 13 below shows the London area airport shares of passengers flying within Europe. Given that Stansted currently only offers flights to short haul destinations, these appear to be the most appropriate market shares to consider. They show that Stansted only has a 21 per cent share of this market, compared with Heathrow with 37 per cent and Gatwick with 29 per cent, which is well below the level at which there would be a rebuttable presumption of dominance.
- 3.10 However, given that Heathrow and Stansted operate in the same market for passengers travelling within Europe and they are currently both owned by BAA, it is the joint market share that is most relevant when considering the degree of market power held by Stansted, which in this case would be equivalent to that held by the BAA. The joint market share is 58 per cent, significantly higher than the level that would lead to a rebuttable presumption of dominance.

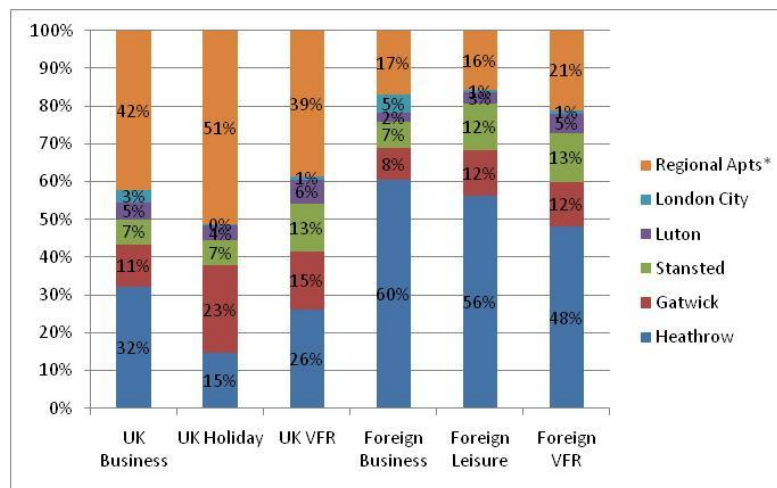
Figure 13 London area airport shares of passengers flying within Europe



Source: CAA airport statistics

- 3.11 Although it was concluded that at this time, there is no compelling evidence to suggest further dividing the market by passenger type, we have still considered a passenger split by journey purpose, in order to assess the whether this conclusion has any bearing on our assessment of market power.
- 3.12 Stansted's highest share on its own is still only 21 per cent of London passengers from the UK visiting friends and relatives (VFR). As shown in Figure 14, these proportions are lower when viewed on a UK-wide basis.

Figure 14 Airport share of passengers by journey purpose and residence 2010



Source: CAA Passenger Survey

3.13 Again, looking at BAA’s share of this market, the airports account for 22 per cent of UK holiday traffic (the lowest combined share across the passenger segments), and 39 per cent of both UK business and UK VFR traffic. By virtue of Heathrow’s share of foreign passengers, the combined shares of foreign business, foreign leisure and foreign VFR are all very high, at 67, 68 and 61 per cent, respectively. All of these shares are significantly higher than the levels that would support a rebuttable assumption of dominance.

From the airline perspective

3.14 In Chapter 2, we concluded that on the evidence currently available, the market definition for Stansted from the airline perspective appears to be mid-sized and larger airports in Europe with a catchment of passengers to generate a sufficient yield.

3.15 We do not have Stansted’s share of passengers flying from these airports in Europe, but it is clearly very low. One way to look at the importance of Stansted to airlines is to look at the share of an airlines business accounted for by Stansted. For Stansted’s biggest customers, Ryanair and EasyJet, these shares are 17 and 8 per cent respectively, suggesting that Stansted does not have a large share of airlines’ business across Europe.

3.16 As discussed in chapter 2, it may be appropriate to consider the provision of infrastructure and infrastructure services at Stansted in the morning peak as a separate economic market. Table 3 below gives the shares of passengers travelling from the five main London area airports at the morning peak. It shows that by this measure, Stansted’s market share is higher than its share of the all day market, although it is still only the third largest player. When we exclude Heathrow, which we do not consider to be a competitor to Stansted for airlines, Stansted’s share rises to 37 per cent. However, we consider Stansted to be part of a wider European market. We do not have the data to calculate the shares on a European-wide basis, but Stansted’s shares would be likely to drop significantly on this basis.

Table 3 London Area airports' shares of departing passengers at the morning peak and throughout the day

	Share of Departing Pax, 2010	
	6-8 am local time	All day
Heathrow	30%	52%
Gatwick	30%	25%
Stansted	26%	15%
Luton	12%	7%
London City	2%	2%
Total	100%	100%

Source: CAA Airport Stats

Summary

- 3.17 On most measures, if we consider Stansted as a stand-alone airport, its market shares, however the market is defined, would not tend to support the view that Stansted has substantial market power and would certainly not support a rebuttable presumption of dominance.
- 3.18 However, while whilst under joint ownership, the shares of Heathrow and Stansted should be combined for any sector in which they jointly operate.⁴⁷ BAA's share of this sector is much larger than Stansted's individual share and above the level that would support a rebuttable presumption of dominance. The implications of joint ownership are discussed further below.
- 3.19 It should also be noted that, as set out in the CAA's *Guidance on the Assessment of Airport Market Power*, there are aspects of airport markets that might reduce the reliability of market shares as an indicator of market power. A number of other factors will affect the assessment of market power, in particular how easily airlines and passengers can switch between airports and how easy it is for competing airports to enter or expand. These factors are discussed further below.

Airline switching

- 3.20 The annex on airline switching gives details on what affects an airline's ability to switch, including a discussion of switching costs and available alternatives. It also gives examples of actual switching to and from the London airports.

Ability of airlines to switch away from Stansted

- 3.21 As discussed above, switching costs will vary by airline business model, type (or extent) of switching and on whether the switch involves moving based aircraft.
- 3.22 The predominant airline business model at Stansted is LCCs, operating short-haul services. In general, these airlines will have invested less at the airport than other airline business models and have multiple bases across the UK and Europe.⁴⁸ In addition, this type of airline business model does not rely on

⁴⁷ While we exclude Heathrow as a strong competitor for Stansted's current airlines, the two airports do compete with each other for passengers.

⁴⁸ As discussed in paragraph 2.136, Ryanair currently operates from 160 airports, with 47 bases; and easyJet currently operates from 123 airports, with 19 bases.

transfer traffic, which means that these airlines do not face the additional switching costs associated with the impact of airline network economics.⁴⁹ These factors imply that airlines at Stansted will generally find it easier to switch away than network airlines.

- 3.23 The table below summarises the costs involved in switching operations to a new base for LCCs and for FSCs operating network and long-haul services. This type of switch would generally incur the highest costs. In contrast, a switch to an airport where the airline already has a base would incur lower costs, with the lowest cost switch being to increase the frequency of an existing route at an existing base. Given that LCCs tend to have bases across Europe, they have more options as to where to switch; again lowering switching costs compared to network airlines.
- 3.24 Illustrating the point further, the Competition Commission refers to evidence provided by BA and Ryanair.⁵⁰ BA stated that it had sunk very large investments at Heathrow: to recreate BA’s maintenance facilities elsewhere would cost about £1 billion. In contrast, Ryanair said that the capital cost of a move from Stansted to Gatwick would be approximately £10–£12 million.
- 3.25 In addition, as discussed in paragraph 2.65, due to the more streamlined cost structure of LCCs, airport charges generally account for a larger proportion of the total costs than they do for FSCs. This implies that there will be a greater incentive for LCCs to switch in response to an increase in airport charges.

Figure 15 Types of costs involved in switching operations (if no existing operations at the new airport)

Network/long-haul carriers (using LHR or LGW as their main base)	Low cost/point-to-point/short-haul carriers
Marketing costs	Marketing costs
Loss of route maturity (yield loss)	Loss of route maturity (yield loss)
Crew and ground staff relocation (if further afield)	Crew staff relocation (if further afield)
Loss of network access – moving one service away from a “hub” may <ul style="list-style-type: none"> • impact on passenger feed for a long-haul route • impact on short-haul route profitability 	
Capital investment costs at new airport: <ul style="list-style-type: none"> • passenger-facing facilities (e.g. lounges) • aircraft maintenance facilities (if shifting a large share of, or all, flights) 	Capital investment costs at new airport: <ul style="list-style-type: none"> • aircraft maintenance facilities (if shifting a large share of, or all, flights)

Sources: Airline interviews and confidential submissions, Competition Commission BAA airports market investigation March 2009, Appendix 3.4 Costs to airlines of switching airports

- 3.26 Even if switching costs are low enough to allow airlines to switch, they must have appropriate alternative airports to switch to. A based carrier at Stansted’s ability to switch to neighbouring airports may be limited by

⁴⁹ These network effects, which affect airlines that transport significant numbers of connecting passengers, arise from the adverse impact that cancelling one service has on the profitability of other services across the network.

⁵⁰ ‘BAA airports market investigation’, Competition Commission, March 2009 in Appendix 3.4: Costs to airlines of switching airports.

constrained capacity at other London airports. However, Stansted has more near-neighbouring airports with capacity than Gatwick. In addition, airlines with a network of bases across Europe also have the option of switching to other, non-London airports; although switching costs may be higher for such a switch.

- 3.27 EasyJet argues, however, that the switching costs it faces are still too high to enable them to switch in order to discipline effectively a 10 per cent price increase. It commissioned analysis from Frontier Economics, which we discuss further below. One way to test this is to look at actual switching, which we do in the next section.

Evidence of switching

- 3.28 While airlines at Stansted are likely to face lower switching costs than airlines with different business models, this does not in itself indicate whether these costs are sufficiently small to allow airlines to switch services in sufficient numbers to discipline a 10 per cent increase in prices. One source of evidence that can be used to understand likely switching behaviour is if actual switching has been observed.

- 3.29 In this respect, Stansted has lost several major airlines to Gatwick recently (Norwegian, Air Berlin and Air Asia X). It is notable that this is despite their being some capacity constraints at Gatwick. The combined impact of the Air Berlin and Air Asia X switches is approximately 3.4 per cent of Stansted passengers, with the Norwegian moves taking place somewhat earlier and accounting for approximately 1.6 per cent of passengers at Stansted.⁵¹ In addition, easyJet has recently announced its intention to move some of its based aircraft from Stansted to Southend.⁵²

- 3.30 [X]

- 3.31 These recent switches imply that at current prices, switching is possible and that airlines do switch.

Analysis of route churn

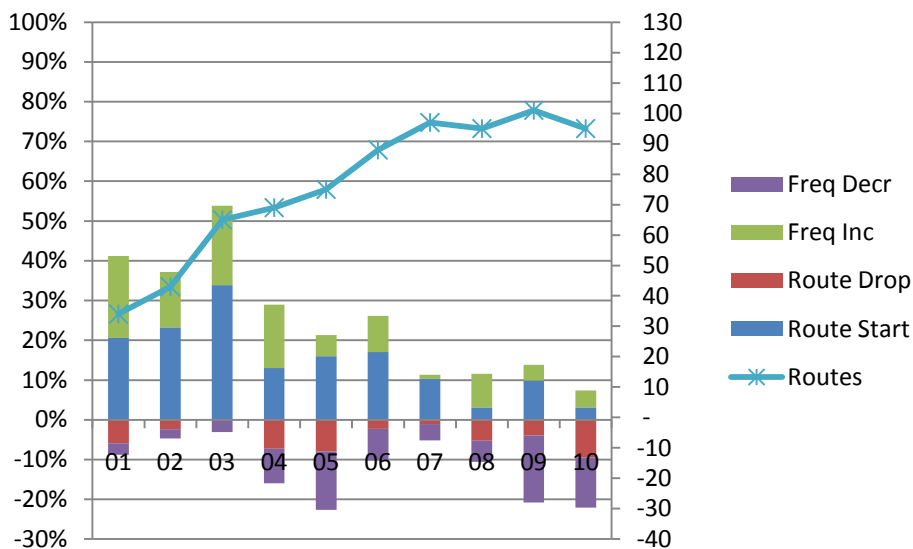
- 3.32 A further source of evidence about the magnitude of switching costs is the extent to which airlines vary their schedules, change the destination of their aircraft, and vary the number of aircraft based at an airport.

- 3.33 Figure 16 below shows that Ryanair has increased and decreased routes and frequencies significantly over the past 10 years. In contrast, easyJet has made relatively fewer changes in its schedule in recent years, apart from a large decrease in 2009 as shown in Figure 17.

⁵¹ These calculations are based on comparing traffic volumes in 2010 by Air Berlin and Air Asia X to total passenger numbers at Stansted. Norwegian did not operate throughout the whole of 2010, and only operated a limited operation in 2009, so we have compared 2008 figures, when the carrier operated multiple routes from the airport. It is worth noting that Norwegian has grown at Gatwick, so the magnitude to the traffic lost from Stansted is arguably greater than that used to calculate this estimate.

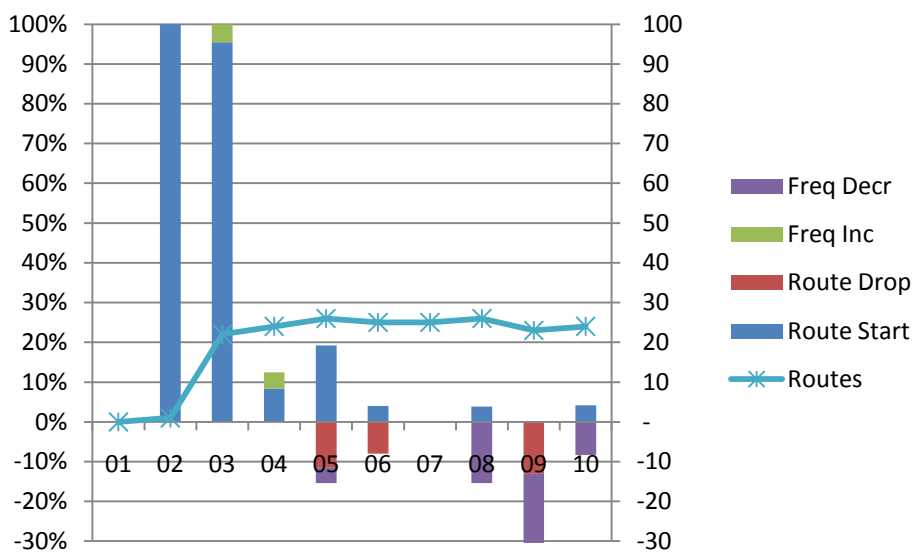
⁵² easyJet estimates that Southend will attract around 800,000 passengers in its first year (although not all of these would have travelled via Stansted): <http://corporate.easyjet.com/media/latest-news/news-year-2011/16-06-2011.aspx>

Figure 16 Routes started/dropped and frequency increases and decreases as a proportion of total number of routes for Ryanair at Stansted and the total number of routes (right axis)



Source: CAA Airport Statistics

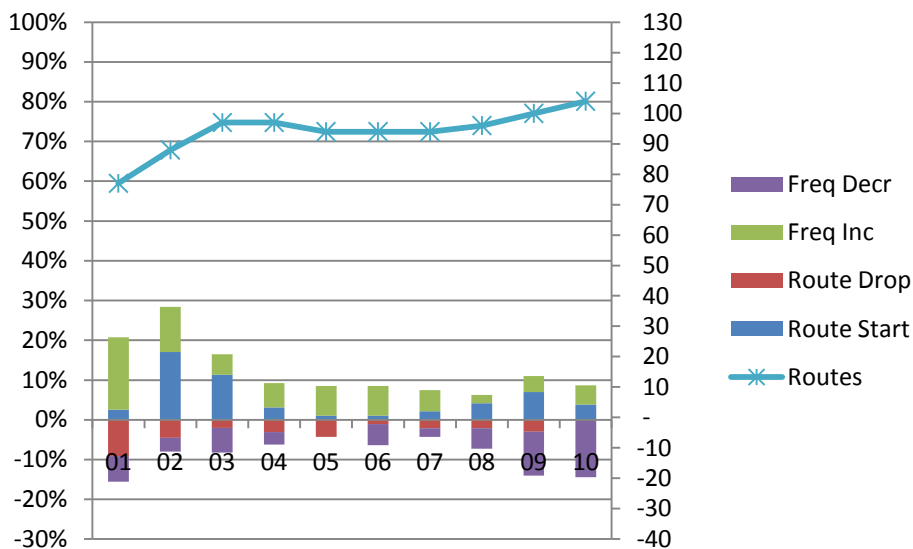
Figure 17 Routes started/dropped and frequency increases and decreases as a proportion of total number of routes for easyJet at Stansted and the total number of routes (right axis).



Source: CAA Airport Stats

3.34 This analysis shows that there is considerable variation in the routes flown from Stansted, albeit within a longer term trend of growth (Ryanair) and relative stability overall volumes (easyJet). In particular, it demonstrates that there is more volatility than for some other carriers – indeed, Figure 18 reproduces similar analysis for BA at Heathrow, which shows much less volatility in routes, with most of the changes taking the form of variations in frequency.

Figure 18 Routes started/dropped and frequency increases and decreases as a proportion of total number of routes for BA at LHR and the total number of routes (right axis).



Source: CAA airport statistics

3.35 This analysis highlights that the major carriers at Stansted operate particularly dynamic networks, with the routes flown varying to a significant degree over time. It also supports the view that switching costs between airports that are not bases seem unlikely to represent a significant barrier to airline switching. This analysis does not, however, establish whether the major airlines at Stansted face significant costs when switching aircraft away from Stansted, as the overall number of aircraft based at Stansted has not varied markedly over time. The examples of switching highlighted above provide some evidence on this form of switching.

Passenger switching

Ability of passengers to switch away from Stansted

3.36 As discussed above in chapter 2, the main cost to passengers switching between airports is the difference in travel times and cost of travel to the different airports. So long as a suitable destination is served by an alternative airport, a passenger is likely to be able to switch there at little cost other than those relating to surface travel.

3.37 As stated above, survey evidence suggests that in choosing an airport, location is the most important factor, followed by the availability of the route and the cost of the flight. This implies that, whilst passengers are likely to prefer to travel from their nearest airport, price and route availability are also important factors. Consequently, there is the potential for passengers to be reasonably price sensitive, and in particular where the same flight is available at another local airport.

3.38 It is useful, therefore, to consider evidence from passengers' use of the airport to understand the extent to which passengers are likely to switch between Stansted and other airports. This is considered in the next section.

Evidence of switching/ potential to switch

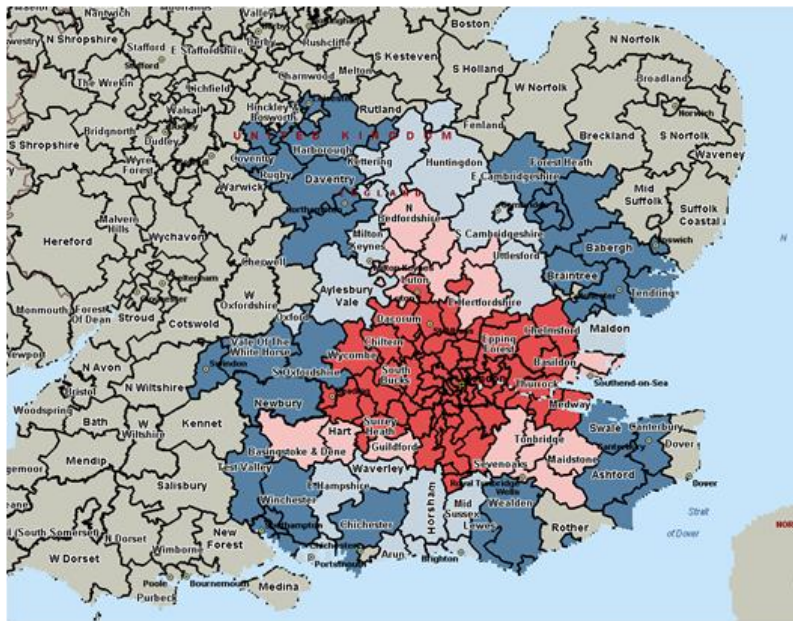
- 3.39 Given that the greatest cost to passengers in switching airport is likely to be the difference in travel time and cost, in order to assess the likelihood and potential for passengers to switch, it is useful to consider the catchment area of Stansted and which airports also draw passengers from within that catchment area. It is also useful to consider survey evidence on which airports Stansted passengers have used in the past, the airports they would consider using and their likely reaction to an increase in fares.
- 3.40 This section considers catchment area analysis, survey evidence and modelling undertaken by Frontier, using the DfT's passenger allocation model.

Catchment area analysis

- 3.41 The catchment area analysis paper considers the catchment areas of Heathrow, Gatwick, Stansted and Luton under different measures. The results of Stansted's catchment area analysis are included in the section above on geographic market definition. We will now consider further how the catchment areas of Stansted's nearest airports overlap with each other and therefore the likely alternative airports for Stansted's passengers.
- 3.42 As highlighted above, most passengers travel up to 90 minutes to get to Stansted, suggesting that Stansted's catchment should include all areas within 90 minutes drive of the airport. On this measure there is a significant overlap between Stansted's catchment and that of Heathrow, Gatwick, Luton and London City airports. Indeed, all these airports lie within a 90 minute travel time of Stansted airport, suggesting that they are alternatives for a significant proportion of Stansted's passengers.⁵³
- 3.43 Furthermore, by looking at how the various London area airports' catchments overlap, it is possible to assess the alternatives available for passengers located in different areas.

⁵³ Some passengers, particularly those to the north-east of Stansted would face a longer travel time to these other airports, as they would need to travel past Stansted to reach them. Other passengers, such as those in Greater London, are more likely to face a lower increase in overall travel time should they switch between Stansted and the other London airports.

Figure 19 Overlap of districts within 90 minutes



Source: CAA analysis of DfT surface access data
 Blue: 1 airport; Light blue: 2 airports; Light red: 3 airports; Red: 4 airports

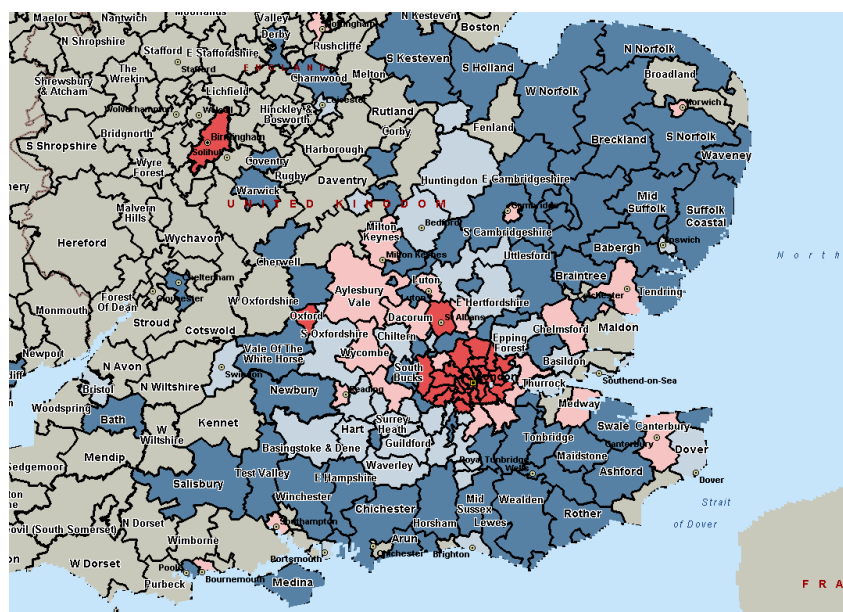
- 3.44 Figure 19 shows all the districts in the south east within a 90 minute travel time of Stansted, Gatwick, Heathrow or Luton or some combination of these. It shows that passengers travelling from greater London have the greatest choice (i.e. of all four airports) within 90 minutes travel time.⁵⁴
- 3.45 These passengers with the greatest choice are likely to be the most marginal passengers: given that it is easy for them to travel to all four main London airports, they are likely to be more sensitive to any increase in price.
- 3.46 As shown in our catchment area analysis paper, this area of greatest overlaps is also the most densely populated area, suggesting that a significant proportion of passengers are likely to be marginal. However, the ability of these passengers to switch between these airports is still going to be restricted by the availability of routes. We consider this aspect further below.
- 3.47 An alternative way to assess the strength of overlaps is to consider the historical usage pattern of each airport, rather than relying on surface travel times from each district. Looking at the overlap of catchments using historical usage, as shown in Figure 20 below, shows that the area where all four catchments overlap shrinks considerably. This is likely to reflect the fact that passengers generally have a preference for their closest airport, even when alternative airports are available nearby.⁵⁵ The figure also shows that the number of districts served by the airports is wider than a 90 minute travel time suggests, although for these further away districts, passengers appear to have fewer choices.

⁵⁴ These passengers would also have relatively easy access to London City Airport.

⁵⁵ Indeed, a lack of overlaps in historical usage should not be interpreted as necessarily indicating a lack of choice and competition. Competing airports with similar offers might be expected to produce a pattern of usage where passengers use their closest airports and there are relatively low overlaps between catchment areas based on historical usage.

3.48 Nevertheless, the area with the most overlap is still Greater London, where passengers from most districts have travelled to at least three airports.

Figure 20 Overlaps of historical actual usage catchment areas using 80% passengers



Source: CAA analysis of the CAA Passenger Survey (2010)
Blue: 1 airport; Light blue: 2 airports; Light red: 3 airports; Red: 4 airports

Survey evidence

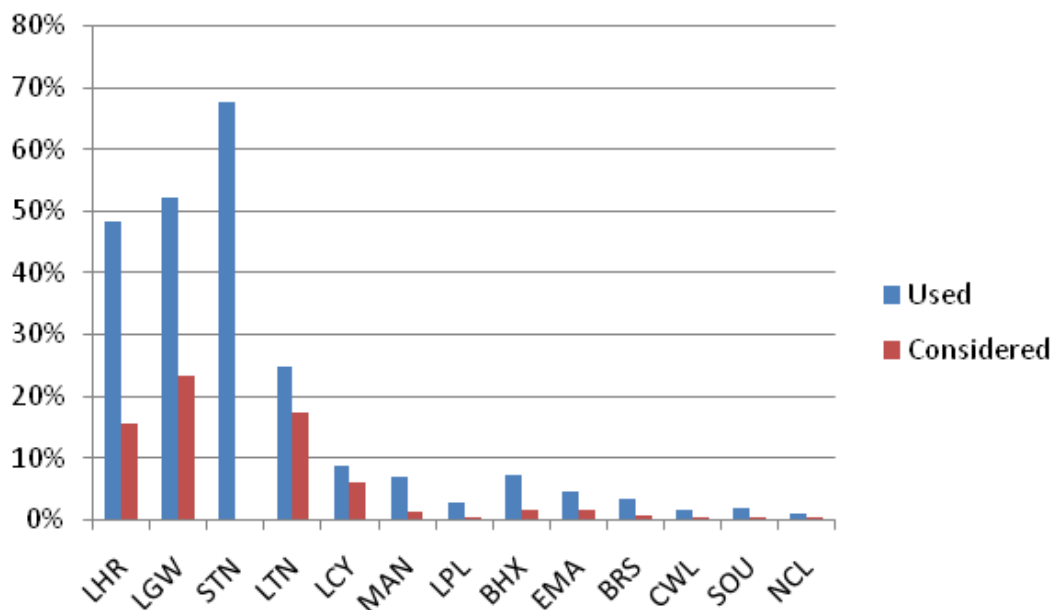
3.49 Another way to assess the ability of and likelihood that passengers switch away from Stansted is to ask them directly. Our working paper on the passenger survey results gives a detailed analysis of the survey data.⁵⁶ We consider the most relevant analysis for Stansted below.

3.50 Figure 21 below shows the airports previously used and considered by passengers at Stansted in the last two years. It shows that around half of passengers at Stansted had previously used Heathrow or Gatwick, with approximately one quarter considering these airports (although Heathrow was considered less than Gatwick). Around a quarter of passengers at Stansted had used Luton previously, with a similar number considering it for their current journey, making it the second most considered airport after Gatwick.

3.51 These results suggest that there are significant numbers of Stansted passenger who have previously used another London airport (indicating a degree of willingness to travel to use these airports) and that stated that they had considered alternative airports to Stansted. This supports the view that these three airports should be considered as close competitors to Stansted in attracting passengers.

⁵⁶ 'Passengers' airport preferences: results from the CAA Passenger Survey', CAA, November 2011

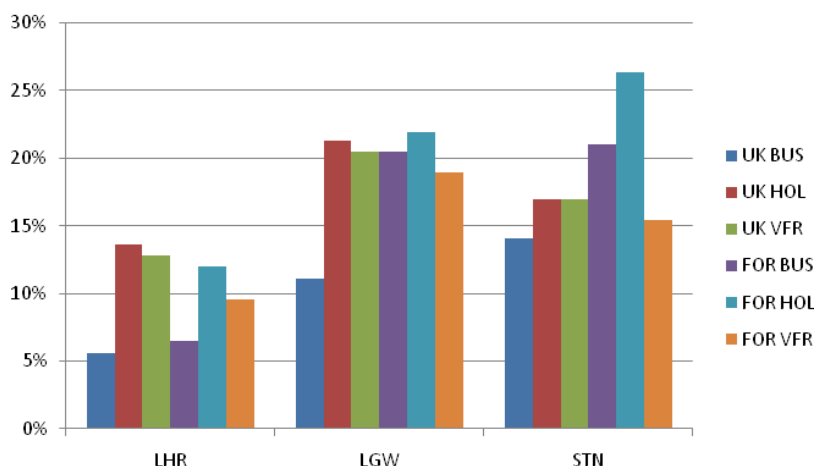
Figure 21 Airports previously used in the past two years and airports considered as alternatives for current flight by short haul passengers at Stansted



Source: CAA analysis of CAA Passenger Survey data – supplementary stated preference question

3.52 The passenger survey also asked passengers what their response to an increase in price (£10 for short haul) would be. Figure 22 below shows that over 15 per cent of passengers in each passenger group, except UK business passengers, would switch away following an increase in price.⁵⁷ It should be noted that these measures of responsiveness are based on changes in airfares, and an increase in airport charges of 5 to 10 per cent will not have as large an impact on airfares. This is discussed in more detail below.

Figure 22 Short haul passenger price responsiveness to an increase in the cost of using their current airport, by journey purpose and residence



Source: CAA analysis of CAA Passenger Survey data – supplementary stated preference question

⁵⁷ The survey asked passengers whether they would respond to changes in airfares. This is not equivalent to saying that they would respond to a change in airport charges to the same degree, as this will depend upon the link between airport charges and airfares. The analysis is, therefore, more useful to consider the relative price sensitivity of passengers rather than it being a direct indicator of responsiveness to airport charges – which would require further analysis to establish.

- 3.53 The results of this survey highlight the differing degrees of price responsiveness at the three airports, with Heathrow showing less responsiveness than Gatwick and Stansted.
- 3.54 In general, there is no consistent pattern of responsiveness between Gatwick and Stansted. Foreign Holiday and UK Business passengers appear more responsive at Stansted than at Gatwick, whilst VFR and UK Holiday passengers appear less responsive at Stansted. These differences between Stansted and Gatwick may not, however, be significant.

Modelling of passengers' willingness to switch airports

- 3.55 In its report for easyJet, Frontier estimates the number of passengers that would leave Stansted in response to a 10 per cent rise in the airport's aeronautical charges.
- 3.56 Frontier used the DfT's passenger demand forecasting model NAPALM⁵⁸. It estimated that about 0.69 million passengers (per annum) would want to switch from Stansted to other airports, in response to a 10 per cent increase in charges, provided there were no capacity constraints at any of the other airports. These passengers would switch to Gatwick (0.5mppa), Heathrow (0.15mppa), Luton (0.11mppa) and other airports.
- 3.57 In an alternative scenario Frontier assumed that passengers could not switch to either Heathrow (due to capacity constraints) or London City (due to the limited number of available routes and constraints on aircraft size), which reduced the number of passengers willing to switch away from Stansted to 0.61 million (per annum).
- 3.58 Using the DfT's NAPALM model in this way, despite being primarily designed to estimate long-run passenger demand forecasts rather than short-run reactions to price increases at one specific airport, is a useful contribution to attempting to assess the impact on passenger numbers at Stansted resulting from a unilateral price increase.
- 3.59 Nevertheless, its methodology and underlying assumptions involve a number of features⁵⁹ that suggest that the estimated number of passengers is likely to be at the lower end of the spectrum:
- The calculation assumes a full pass-through of the airport charge increase to passengers. However, airlines have previously told us that in the short-run such price increases would be absorbed fully by the airlines and only incorporated over the following scheduling seasons.
 - The model holds total passenger demand fixed, meaning it assumes that no passengers would leave the market but always switch to an alternative airport. It might be that a number of passengers, instead of going to a different airport, might abandon their flight altogether.

⁵⁸ The National Air Passenger Allocation Model is a fully-estimated multinomial choice model that is used to convert unconstrained forecasts of air passenger demand into forecasts of passenger demand by airport.

⁵⁹ While these may be appropriate assumptions for a long-run forecasting model, they are likely to understate the level of short-run passenger switching away from a single airport in response to a price increase.

- The model treats passengers of FSC and LCC separately; for example, LCC passengers faced with a price increase at Stansted cannot substitute to FSC services at Heathrow.
- The model does not seem to allow for route substitution; for example, a passenger flying to Charles de Gaulle airport can only switch to another flight to Charles de Gaulle.
- An initial analysis of the model suggests that regional UK airports would generally lose a lower percentage of their passengers in response to a similar price rise than would any of the London airports. Given that regional airports are generally regarded as competitive, we need to understand better whether a high or low share of estimated passenger switching can indeed be interpreted as suggesting a high or low degree of market power, absent any further explanations.
- Furthermore, we do not think it is appropriate to prevent passengers from switching to Heathrow. While Heathrow's runway capacity might be constrained, there is still capacity to accommodate additional passengers (through larger aircraft and higher load factors).

3.60 Overall, the modelled responsiveness of passengers to price may appear relatively high, considering that a 10 per cent rise in the airport's revenues would only constitute a fraction of a passenger's total travel costs. However, a large number of Stansted's passengers originate from the Greater London area, which is the most contested geographical area, and a high proportion of Stansted's passengers travel on routes that are also offered from at least one other London airport. It might therefore be plausible that passengers could react even to small differences in price, as the model suggests.

Route availability

3.61 Some passengers will tend to have a fixed destination, so would only consider airports where flights to their chosen destinations were available.⁶⁰ The degree to which passengers are willing to switch between destinations will tend to vary with their journey purpose, with those travelling for business or for VFR being less likely to switch than those travelling on holiday. For those less willing to switch destination, the availability of services at different airports can affect the degree to which passengers will switch between airports in response to changes in price or service.

3.62 For some services, their destination might be served equally well by a number of destination airports, some of which might be captured by being considered as serving the same city (e.g. Rome Fiumicino and Ciampino would both be captured by a city pair London-Rome), but others might not be captured (e.g. Valencia, Alicante and Murcia could be considered as reasonable substitutes to go to the south east coast of Spain). However, assessing overlaps of city pairs between London airports provides some indication of the level of choice passengers (with strong destination preferences) currently have between airports. It should be noted, however, that this is only a snapshot, as airlines

⁶⁰ Some passengers might be able to switch between different destinations, for example for another nearby airport close to their final destination or a different holiday destination all together.

regularly change their route network, so that the degree of overlap might change in both directions over time.

- 3.63 Figure 23 shows the level of city pair overlaps for short haul flights in the London area. It shows that 60 per cent of routes available at Stansted are also available at other London airports. Stansted has the lowest proportion of overlaps, reflecting the fact that it also serves the highest number of short haul destinations (provided predominantly by Ryanair), including to a number of relatively small destination airports.

Figure 23 Number of short-haul and domestic route overlaps between LON airports, 2010

	Cities Served	Overlaps	% overlap	LHR	LGW	STN	LTN	LCY
LHR	64	55	86%		47	33	28	16
LGW	121	92	76%			65	48	21
STN	131	79	60%				42	16
LTN	69	59	86%					13
LCY	26	24	92%					

Source: CAA airport Stats

- 3.64 However, 60 per cent is still a significant proportion and if we weight this by passenger numbers on these routes, we see that 74 per cent of passengers could fly to the same destination from another London airport.
- 3.65 As the strength of competition is determined by the marginal passengers – i.e. those most able to switch between airports – this analysis supports the view that there is considerable scope for passengers at Stansted to switch between airports, even if passengers have very strong destination preferences.

Implications of passenger and airline switching and the multisided nature of the market

- 3.66 The previous two sections looked at airlines' and passengers' ability to switch and evidence of actual switching. Given that airports provide services to, and earn revenues from, both airlines and passengers, and that airlines also provide services and earn revenues from passengers, it is important to consider these interrelationships in assessing an airport's ability to exert market power.
- 3.67 If an airport raises its prices to airlines, airlines are likely to raise their prices to passengers (certainly in the long term, if not immediately). In examining whether or not an airport can profitably raise its prices, it is therefore important to assess the effect of the rise in price on airlines and passengers combined.
- 3.68 Given that airlines at Stansted largely offer short-haul point-to-point flights and that it is generally accepted that the market for short-haul flights is competitive, we would expect that prices to passengers are competitive. In competitive markets, prices will over time reflect costs of supply – in particular, the forward-looking (or marginal) costs of supply. As such any increase in airport charges (a marginal cost) is likely to be fed through to passengers. Any unanticipated changes in airport charges might reduce the

speed with which airfares adjust, as airlines will have announced their schedules and commenced sales of tickets. However, to the extent that a price rise is anticipated, there might be a reasonable expectation that these costs would be incorporated into fleet planning and pricing decisions.

- 3.69 In this context, it is relevant that the Airport Charges Regulations impose obligations on larger airports, including Stansted, that require regular consultation and transparency on charging. These obligations mean that (absent price control regulation) the airport is required to announce its charges in advance and thus provide airlines with an opportunity to vary their fleet planning and pricing before the higher charges apply.⁶¹ Overall, therefore, an increase in Stansted's charges to airlines is likely to lead to an increase in ticket prices to passengers.
- 3.70 As shown above, many passengers flying from Stansted have the choice of a number of different airports to fly from, with a large proportion (i.e. those within 90 minutes travel time of all four main London airports) having limited switching costs. The pool of marginal customers is therefore potentially fairly large. An increase in prices is therefore likely to induce at least some passengers to switch to another airport. Indeed, modelling undertaken by Frontier, using DfT data, indicated that there would be significant passenger switching between airports in response to changes in airfares (this is discussed in more detail below).
- 3.71 For airlines operating marginal routes, this loss of passengers may render some routes unprofitable. The airline may therefore cease to operate that route and switch an aircraft to another airport. If no other airline is serving that route at Stansted, the airport is likely to lose the majority of the passengers from that route.
- 3.72 In this respect, it is relevant that in 2010 only around 10 per cent of Stansted's passengers were on regularly-served routes served by more than one airline at Stansted.⁶² These overlaps were between Ryanair and easyJet for five popular Spanish and Portuguese holiday destinations; and between Air Berlin and Germanwings for Hannover and between Pegasus and Turkish Airlines for Istanbul. This implies most routes at Stansted are only run by one airline and therefore, if a route was cancelled, Stansted would be more likely to lose the passengers from that route to another airport. This is most likely to be the case for VFR and business passengers.
- 3.73 This interplay between passengers and airlines indicates that the loss of business to an airport resulting from an increase in price may be greater than indicated by the impact on 'marginal' passengers: it may also include additional passengers on any routes that become unprofitable, who would then need to travel to a different airport to get to their destination.

⁶¹ For example, the Airport Charges Regulations 2011 requires airports meeting the size threshold to provide 4 months notice of any intention to vary the level of airport charges.

⁶² Routes with at least 100 departures in the year.

Airport sensitivity to passenger and airline switching

- 3.74 As discussed above, to assess Stansted's ability to exercise market power, we consider how likely it is for Stansted to be able to profitably raise prices by 5-10 per cent. The sections above consider the ability of airlines and passengers to react to a price increase at Stansted by switching away, which allows us to assess the likely proportions of passengers that may switch in response to a price rise.
- 3.75 To understand the airport's market power, we need to combine this evidence about the magnitude of potential switching with an understanding of the airport's sensitivity to reductions in passenger and airline volumes, as it is this sensitivity that will determine the airport's incentives to compete. To do this, we can estimate the number of passengers that would need to be lost in order to make a 5 or 10 per cent increase in price unprofitable. This is known as a critical loss analysis.⁶³
- 3.76 This can then be compared with the number of passengers that would be likely to switch in the face of such a price rise. If it shows that a greater proportion of passengers are likely to switch than the number that would render such a price increase unprofitable (i.e. the critical loss number), then this implies that the airport does not have substantial market power.
- 3.77 The calculation involved to estimate the critical loss of passengers is relatively straight-forward. However, it involves a number of assumptions to be made about the airport's costs and revenues. It is also difficult to summarise the analysis on passenger and airline switching into a single number, due the large number of factors that affect this and the difficulty in quantifying them, as outlined above.
- 3.78 We have calculated the volume (passenger) loss at which a price increase of 5 or 10 per cent becomes unprofitable, under a certain set of assumptions.^{64,65} A price rise can be applied by the airport in different ways, for example across aeronautical charges or across a combination of both aeronautical and non-aeronautical charges. The CAA's *Guidance on the Assessment of Airport Market Power* considers the implications of the fact that airports generate revenues from both passengers and airlines. As an increase in charges could result in higher charges to passengers, airlines or both – and could take the form of higher charges for essential passenger-facing services – it is important to consider the critical loss that results from a 5 or 10 per cent increase in airport revenue per passenger, in addition to that which might result from an increase only to aeronautical revenues.
- 3.79 Reflecting this, the critical loss figures in Table 4, for 5 and 10 per cent increases in price are shown for these two different methods. Additionally, fluctuations in an airport's operating costs may be linked to some degree to

⁶³ Critical loss analysis is also relevant to understanding the relevant market within which an airport operates. We have chosen to present the information within the assessment of the market power for ease of exposition. The conclusions are, of course, relevant to the analysis of market definition.

⁶⁴ The critical loss is therefore the volume loss that would make the airport indifferent between raising prices and keeping them at their existing levels.

⁶⁵ More information is included in the Annex to this paper.

changes in its passenger numbers. As a result, critical losses are calculated assuming fixed operating costs, and assuming a staff to passenger elasticity of 0.3 between operating costs and passengers.⁶⁶ That is, operating costs per passenger fall 30 per cent for each passenger switching away.⁶⁷

Table 4 Critical loss calculations for Stansted

SSNIP increment	Increasing aeronautical revenue		Increasing total revenue	
	5%	10%	5%	10%
Passengers	18308000	18308000	18308000	18308000
Aeronautical Revenue	121,600,000	121,600,000	121,600,000	121,600,000
Non-Aeronautical Revenue	97,500,000	97,500,000	97,500,000	97,500,000
Total Revenue	219,100,000	219,100,000	219,100,000	219,100,000
Operating Costs	133,400,000	133,400,000	133,400,000	133,400,000
Current				
Aeronautical Revenue per Passenger	6.641905178	6.641905178	6.641905178	6.641905178
Non-Aeronautical Revenue per Passenger	5.325540747	5.325540747	5.325540747	5.325540747
Total Revenue per Passenger	11.96744593	11.96744593	11.96744593	11.96744593
Operating Costs per Passenger	7.286432161	7.286432161	7.286432161	7.286432161
After price increase				
Aeronautical Revenue per Passenger	6.974000437	7.306095696		
Non-Aeronautical Revenue per Passenger	5.325540747	5.325540747		
Total Revenue per Passenger	12.29954118	12.63163644	12.56581822	13.16419052
Increase in Revenue	6,080,000	12,160,000	10,955,000	21,910,000
Critical loss with fixed costs	494,327	962,662	871,810	1,664,364
Critical loss with cost savings	601,170	1,164,115	1,055,406	1,995,762

Source: Stansted 2010 Regulatory Accounts

3.80 The second and third columns of Table 4 show the critical loss calculations for cases where the airport increases only its aeronautical charges by 5 or 10 per cent, keeping non-aeronautical revenue unchanged.⁶⁸ The required loss of passenger volume for a price increase to be unprofitable is 494,327 for a 5 per cent increase and 962,662 for a 10 per cent increase of aeronautical charges, assuming operating costs per passenger are fixed. These volumes increase to 601,170 and 1,164,115 respectively when a cost saving for each lost passenger is assumed.

3.81 However, Stansted could, in principle, also increase some non-aeronautical charges, particularly those charges that are unavoidable for airlines and/ or passengers. If Stansted is found to have market power, it is likely to have market power over all services connected to passengers' and airlines' use of the airport and therefore the ability to raise prices above the competitive level for these services.

⁶⁶ This staff-passenger elasticity was adopted by the CAA and the Competition Commission in the Q5 price control review, in order to forecast operating costs.

⁶⁷ Another way of describing a 0.3 staff to passenger elasticity is that, for a 10 per cent fall in passengers, the number of staff would be expected to fall by 3% percent.

⁶⁸ This methodology was employed in the Frontier Economics report for easyJet, available on the CAA website: http://www.caa.co.uk/docs/5/rpt-easyJet%20Competition%20Assessment%20Final%20Report_Abridged.pdf

- 3.82 Under the assumption that the airport raises both aeronautical and non-aeronautical charges, the required losses in passenger volumes to make an increase unprofitable are 871,810 and 1,664,364 for a 5 and 10 per cent increase in total revenue per passenger respectively. These figures increase to 1,055,406 and 1,995,762 if we assume the airport makes a cost saving for each lost passenger.⁶⁹
- 3.83 The range of passengers that would need to be lost in order to render a 5-10 per cent price rise unprofitable is therefore 3-11 per cent of total passengers, depending on the varying assumptions used.
- 3.84 As discussed above, survey results showed that over 15 per cent of Stansted's passengers would switch away from Stansted following a £10 increase in airfare. This is equivalent to roughly 10 per cent of the average short haul airfare. However, the airport charge is just a proportion of the total airfare. So a 10 per cent increase in airport charges would lead to a lower percentage increase in airfare.
- 3.85 Evidence available for easyJet above suggests that airport charges account for between 28 and 45 per cent of the airfare. So a 10 per cent increase in airport charges that are fully passed through would imply a 3-5 per cent increase in airfare. Unfortunately the survey did not ask passengers for their response to this, smaller increase in airfare.
- 3.86 Given the larger price difference that was used and the accepted flaws of asking hypothetical questions in surveys, this analysis and the overall comparisons cannot be relied upon to give a definitive answer on the airport's market power.⁷⁰ However, it is useful insofar as it indicates that the switching and critical loss figures are of a similar magnitude, indicating that the impact of a 5-10 price rise is not clear from the currently available evidence.

Frontier analysis

- 3.87 EasyJet commissioned Frontier to analyse the potential for airline switching to constrain prices at Stansted, undertaking similar calculations to those set out above. Frontier's paper argues that the costs for easyJet of switching from one airport to another exceeds 10 per cent of aeronautical charges, implying it would have no incentive to switch following a 10 per cent increase in these charges. It also shows that the level of passenger switching following a 10 per cent increase in aeronautical charges (assuming full pass-through) would not be sufficient to render such an increase in charges unprofitable.
- 3.88 The report provided a useful analysis of the impact of an increase in prices on airport profits.

⁶⁹ These figures are approximately double those of an increase in aeronautical revenue only. The explanation lies in the fact that, due to the approximately 55%-45% distribution of total revenue across aeronautical and non-aeronautical revenue, a 10% (5%) increase in aeronautical revenue per passenger results in an overall increase of 5.4% (2.6%) approximately in total revenue per passenger. As a result, increasing total revenue per passenger by the same increment would have a more considerable impact.

⁷⁰ Indeed, the analysis of critical loss and of switching should take place at the competitive price level, rather than at the prevailing price level, which could further limit the conclusions that can be drawn from the analysis.

- 3.89 However, there are a number of factors that affect the way that the results should be interpreted⁷¹:
- The report's analysis of airline switching restricts any switch to be within the London market. However, there is evidence that the airlines at Stansted compare yields across a European market; which is consistent with the CAA's view on the likely scope of the geographic market within which the airport is operating when competing for airlines.
 - The analysis of passenger switching also restricts passengers' choices. In particular, the model does not allow for the possibility of passengers exiting the market following a price rise (i.e. to decide not to travel), and instead only allows them to switch or stay where they are. It also assumes that airlines can only switch to other London airports. These assumptions are likely to lead to an underestimate of the level of passenger switching.
 - The interaction between passenger switching and route profitability does not incorporate the impact that lower passenger numbers might have on route profitability (something which is likely to be particularly complicated to model) For example, if an increase in airport charges induces a drop in passenger numbers, and that drop in passenger numbers renders some marginal routes unprofitable and these routes are not served by other airlines at the same airport, most of the passengers on those routes will also be lost. The results may therefore underestimate the loss of passengers from the airport following a 10% increase in passenger charges (depending on the number of passengers that would need to be lost to render a route unprofitable).
- 3.90 The CAA also has some concerns with the input assumptions used for airline switching costs. In particular, the level of marketing spend and revenue loss that easyJet has provided to Frontier is that associated with a new route. This might not be the most appropriate figure, as an airline might be expected to switch aircraft to existing bases and potentially increase frequency on existing routes. These forms of switching would tend to result in lower marketing costs than in the scenario used to generate the switching cost assumption.
- 3.91 This implies that the estimates relate to a particular form of switching (i.e. to a different airport to operate a new service) and might, therefore, over-state that actual marketing costs involved in the most likely form of switching. This might suggest that the switching costs are too high and the estimated airline response is lower than would happen in practice.
- 3.92 In general, the methodology considers two separate approaches for airlines and for passengers – considering switching from the passenger perspective, but considering the impact on incentives from the airline perspective – without taking into account the interplay of the two user groups. However, we acknowledge that taking into account these externalities in quantitative

⁷¹ It should be noted that these factors are examples of the types of limitations that are typically experienced when the complexity of markets are simplified to allow a tractable model to be constructed.

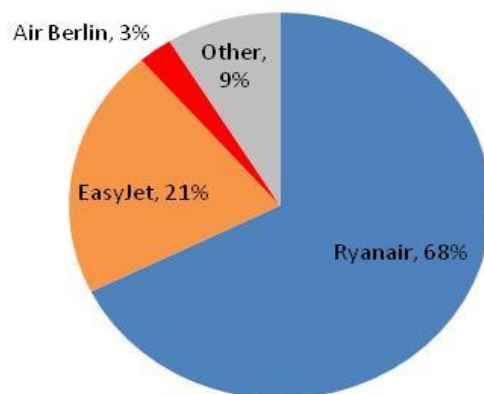
analysis is very difficult, and that the CAA has not attempted to undertake an integrated modelling approach. An example of the impact of this approach is the approach to considering capacity constraints, where the possibility of switching to Heathrow is removed, on the basis that there is limited capacity for airlines to switch to Heathrow. This ignores the potential for passengers to switch to the airport.

- 3.93 The impact of Frontier's approach is that it is likely to underestimate the degree of switching and overestimate the cost of switching, making it more likely that they reach a conclusion that switching would not be sufficient to defeat a 5-10 per cent price rise.
- 3.94 Despite this, the report clearly adds to the overall evidence base and is a relevant piece of evidence to consider in the round. We will also consider how we might build on the approach adopted by Frontier, in ways that might address the points that we make above, such as by investigating whether there are different input assumptions on the adverse impact of switching on airline yields.

Buyer power

- 3.95 In recent years, Stansted has had an increasingly concentrated customer base. As the figure below illustrates, Ryanair accounts for 68 per cent of its passengers, while EasyJet accounts for a further 21 per cent. This concentration is already considerably higher than at the other London airports, and seems likely to increase further in light of the airlines that have switched away from Stansted during 2011 and easyJet's intention to switch a number of services from the airport to operate from Southend from April 2012.

Figure 24 Airline shares of passengers at Stansted 2010



Source: CAA Airport Statistics

- 3.96 Furthermore, the shares of Ryanair and easyJet's businesses that passengers at Stansted account for are only 17 and 8 per cent respectively, as shown in Figure 25.

Figure 25 Airline concentration at Heathrow, Gatwick and Stansted

Airline	Airport	% of total airline passengers	% of total airport passengers
British Airways	Heathrow	78	39
	Gatwick	13	14
easyJet	Gatwick	25	35
	Stansted	8	21
Ryanair	Gatwick	2	4
	Stansted	17	68
Virgin	Heathrow	66	5
	Gatwick	27	5

Source: CAA Airport Statistics

- 3.97 When comparing these two figures, it appears that Stansted is significantly more reliant on the two largest airlines at Stansted than these airlines are reliant on the airport. In addition, this position contrasts somewhat with both Gatwick (where there is approximate symmetry between the airline and airport figures) and Heathrow (where the major airlines are particularly reliant on the airport). Further, as airlines have switched away from Stansted and the major airlines have grown their businesses elsewhere, it appears that the relative bargaining position has shifted to towards the airlines.
- 3.98 On the face of it, these figures suggest that, with a credible alternative to switch to, easyJet and, in particular, Ryanair could have quite considerable bargaining power with Stansted.

RBB report

- 3.99 Ryanair submitted to the CAA a report by RBB Economics, commissioned to look into Ryanair's ability to exercise buyer power.⁷² It does this firstly by estimating an elasticity of demand and looks at the impact on Ryanair volumes of price rises over the last 4 years. RBB calculates a low elasticity of demand, which reflects the small reductions in volume that followed the date at which the agreements with Ryanair expired, and the significant difference between the prices in these agreements and the airport's published tariff.
- 3.100 However, this result (implicitly) relies upon the assumption that the prices prevailing at Stansted before 2006 were approximately equal to the competitive price level. The reliance that can be placed on these elasticity estimates, and the implications that can be drawn from them, depends upon whether the increase in prices following the expiry of long-term contracts was an increase in price towards the competitive level, or was an increase from a price level that was close to the competitive level.

⁷² RBB's report is available at: <http://www.caa.co.uk/docs/5/rbb%20stansted%20final%20non-confidential%20version%2029%20Nov%2011.pdf>

- 3.101 Analysis in the next section suggests that Stansted's prices were low relative to other UK airports between 2001 and 2006 and appear currently to be broadly in line with a number of comparators. This evidence implies that the elasticity estimates calculated by RBB relate to the responsiveness of airlines to an increase in prices towards the competitive level, which would be expected to be below that relating to an increase above the competitive level.
- 3.102 RBB also emphasises the importance of London as a base for Ryanair, as illustrated by the continued significant presence at Stansted despite the price rises. However, it is difficult to separate this general observation from the preceding argument that the airline has not responded to the expiry of a number of long-term contracts. Consequently, the interpretation of the lack of switching could reflect the relationship between the contract prices and the competitive price level, and that potential that the increase in prices paid reflected a movement towards, rather than above, the prevailing competitive price level.
- 3.103 Furthermore, whilst we accept that London may have a particular strategic importance to Ryanair, which might prevent it from removing its entire operations from Stansted, or from airports in London, this does not necessarily imply that the airline cannot reduce its use of Stansted, or of other London airports. Indeed, Stansted – and, more generally, the London airports – failed to attract significant growth from Ryanair in recent years. This suggests that if there is a strategic importance to operations that limits switching away from Stansted, these costs are most likely to relate to the minimum number of services that Ryanair could operate into London, whilst maintaining a significant overall presence, rather than relating to the number of aircraft that need to be based at any particular airport.
- 3.104 One way to consider the issue further would be to analyse the contribution of Ryanair's Stansted operation, in terms of the profitability of the airline and whether the airline gains a form of strategic advantage by operating from London.
- 3.105 [X]
- 3.106 [X]
- 3.107 The paper then goes on to consider Ryanair's buyer power by looking at its possibilities to switch away. It presents qualitative analysis, with supporting evidence, to argue that Ryanair would be unable to switch sufficient ATMs to constrain Stansted. This analysis does not however repeat the earlier calculation of an implied elasticity. Consequently, the only elasticity estimate is calculated from the change in volume that took place following the increase in charges paid by Ryanair at Stansted, which followed the expiry of long-term pricing agreements, as discussed above.
- 3.108 RBB also sets out evidence that Ryanair has grown strongly outside of London, noting that this highlights that there were profitable routes elsewhere. This pattern of growth suggests that growth at Stansted was significantly below that experienced elsewhere and that the pricing change at Stansted led to the airport losing both 32 per cent of its based aircraft between 2007 and

2011 and further growth that ended up being deployed elsewhere (an additional 100 aircraft). This would imply that the elasticity calculated might understate the actual responsiveness of Ryanair at Stansted, as it is based only on the loss of services at the airport, rather than also taking into account the lost growth from new services.

- 3.109 RBB considers the role of passenger switching, but also acknowledges that if Ryanair can switch to other airports – other than those to which passengers can switch – then this would increase its bargaining power. Ryanair’s recent growth in based aircraft has been outside of the UK and outside of the airports serving London and the South East, which strongly supports the view that Ryanair can switch to airports other than those considered by RBB, particularly in terms of switching its growth plans between different airports across Europe.
- 3.110 However, RBB dismisses pan-European switching by citing the CC’s arguments that this would only take place if profitable route opportunities exist elsewhere, as airline capacity is fixed.⁷³ However, RBB presented analysis of Ryanair’s growth outside of Stansted and concluded that “[t]his suggests there were clearly profitable opportunities outside of London that Ryanair could have redeployed aircraft to from Stansted.”⁷⁴ RBB goes on to argue that profitable opportunities will be met through fleet growth rather than through switching, but there is no evidence to support this. Indeed, it appears that the response to a change in relative prices in the short to medium term (which would induce switching of existing aircraft or growth) is being confused with the longer term response to growing demand for the services provided by Ryanair across Europe.
- 3.111 We also note that RBB cites the grounding of aircraft as evidence of high switching costs. However, the seasonal grounding of aircraft appears much more likely to be a response to the seasonality of demand across Europe, so as to better matching capacity to demand. It is not, therefore, clear whether this is evidence of a lack of ability to switch, rather than being evidence of lower yields in winter. Furthermore, Ryanair recently emphasised that the costs of grounding aircraft in winter were reduced by the flexibility of its business model.⁷⁵
- 3.112 RBB also refers to analysis of Ryanair route profitability, which is not set out in its response to the CAA. The CAA will request this information in order to understand better whether the differing yields across Europe provide evidence on the likely magnitude of the costs of switching away from Stansted.

⁷³ RBB report for Ryanair, page 15.

⁷⁴ RBB report for Ryanair, page 5

⁷⁵ “The great thing about our model is that we’re so flexible we CAN sit up to 80 aircraft on the ground and give people holidays, unpaid leave, whatever needs to be done, but NOT lose a bundle of money. The key thing is growth will continue. We’re taking delivery of 30 aircraft from Boeing in calendar 2012, which takes the fleet to 300. I think we’ll be parking less aircraft on the ground next winter, partly because fuel will be smoother, and we’ll have had another year to get our average fares to rise across Europe.”, interview with Michael O’Leary, retrieved from www.anna.aero

- 3.113 Overall, the RBB paper relies on the evidence of actual switching that took place following the increase in airport charges faced by Stansted when its agreements with the airport expired. We do not find the arguments that the airline cannot switch capacity between European bases to be compelling, particularly in the light of the fact that the airline operates on a pan-European basis and its statements that it does indeed switch aircraft between non-neighbouring airports.⁷⁶ Indeed, easyJet also refers to its network optimisation across Europe, which includes opening and closing routes to improve overall financial performance.⁷⁷
- 3.114 Furthermore, whilst we agree that buyer power requires the combination of scale and the existence of an ability to switch away from the airport, we consider it likely that both Ryanair and easyJet have the ability to switch volumes away from the airport. Indeed, the significant number of bases operated by the two airlines, and recent examples of the airlines opening new bases – including the example of easyJet’s switch to Southend – highlights that there is a significant degree of potential switching from these two airlines.
- 3.115 In addition, many of the arguments put forward by RBB depend upon the relationship between the current and historical prices and the competitive price level. In particular, if the long-term contracts entered into between Stansted and Ryanair were below the long-term competitive price level, then the lack of sufficient switching away from the airport to prevent a profitable increase in price might simply reflect the fact that the price rise was taking prices towards the competitive level, rather than above it.
- 3.116 The next sections consider the evidence available about the competitive price level at Stansted.

Evidence on the competitive price level

- 3.117 In the CAA’s Guidance on the Assessment of Airport Market Power, we considered a number of ways in which a competitive price level could be assessed, and stated that the long-term average price level would be assessed using measures of long-run, forward-looking, cost such as depreciated replacement or incremental cost.
- 3.118 The Guidance also noted that:

“... it is important to understand, at a minimum, whether there is evidence that the prevailing and historical price levels are reasonably close to, or significantly above or below, the competitive level. Given the difficulties involved in establishing a competitive price level, it might not always be possible to derive an accurate measure. Nevertheless, where sufficient and robust evidence is available to determine a reasonable estimate, the CAA expects to take full account of it.”

⁷⁶ For example, the airline stated “Ryanair will switch these London based aircraft to other European bases where govts have scrapped tourist taxes and reduced passenger charges, in some case to zero, in order to grow tourism and traffic.” (retrieved from <http://www.ryanair.com/en/news/ryanair-cuts-uk-winter-capacity-by-16-percent>). See also references to the relocation of growth from Dublin to other European airports in <http://www.ryanair.com/en/news/ryanair-confirms-20-percent-cut-in-dublin-summer-2010-traffic>

⁷⁷ See, for example, http://www.easyjet.com/common/img/easyjet_results_YE_2007.pdf

3.119 Gatwick commissioned economic consultants to estimate measures of Long-run Average Incremental Cost (LRAIC) based on a number of different scenarios, basing the capital cost estimates on information on the costs of expanding Gatwick. In addition, we have considered evidence from comparative pricing data from other airports. These different approaches are discussed in turn below.

Long-run average incremental costs (LRAIC)

3.120 Gatwick commissioned the consultancy FTI to provide estimates of Gatwick's LRAIC. Its analysis has been shared with the CAA, and a non-confidential version using different data sources was presented to other interested parties at a workshop in early December. The non-confidential version of their report is available on our website, and a more detailed discussion is included in the CAA's *Gatwick – Market Power Assessment: Initial Views*.

3.121 FTI produced estimates for three different scenarios, drawing heavily on information about the cost of expanding Gatwick Airport. This analysis provided estimates of LRAIC of between £10 and £28/passenger, with the lower estimates being based on the costs of expanding Gatwick up to the maximum use of its current runway, and the higher estimates relating to the costs of building a new runway and associated infrastructure (with these costs being met by incremental traffic only).

3.122 While the calculation of LRAIC numbers is relatively straightforward in methodological terms, any estimates are highly sensitive to the assumptions about the scale of costs involved and the expected scale of future passenger demand. The combination of the inevitable uncertainty attached to the input assumptions, and the reliance on cost estimates that are based on expansion (only) at Gatwick, means that the CAA stated that it is difficult to rely on the FTI estimates in isolation in the context of the market power assessment of Gatwick. In the context of Stansted, where the cost of expansion might be expected to be somewhat different to that at Gatwick, it is difficult to place much reliance on these estimates.

Comparisons with other airports

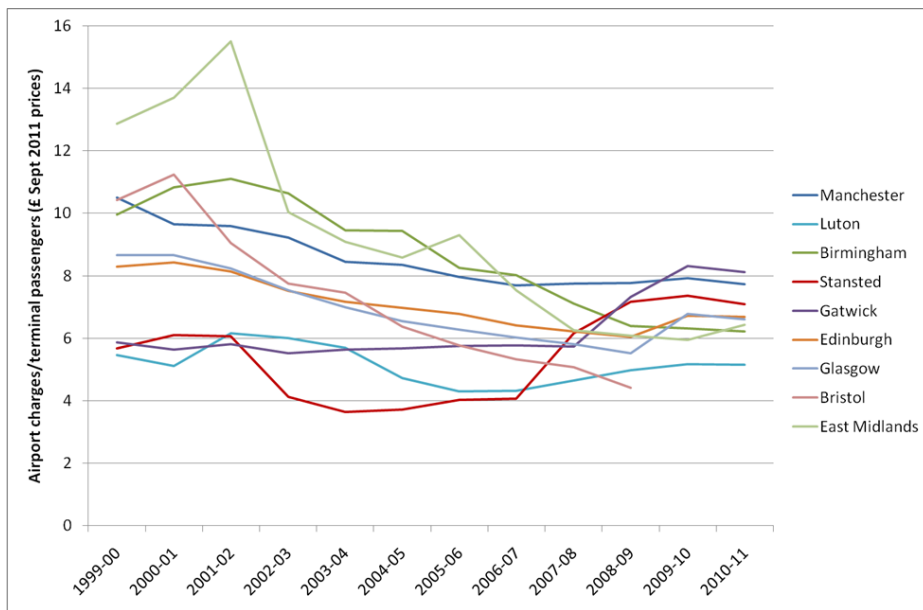
3.123 An alternative approach to calculations based on estimating long-run incremental costs is to consider evidence on pricing at comparable airports. This form of price benchmarking is complicated somewhat by the difficulty in clearly establishing the types of airports that are reasonably close comparators to Stansted. For example, it could be argued that Stansted should be compared to other airports serving predominantly no frills airlines. Alternatively, Stansted is located close to a very strong pool of demand, with relatively good surface access links. The latter view would support a comparison of Stansted to large, but secondary, airports near to large cities and/or large holiday destinations.

3.124 We had access to three sources for price comparison data, that we discuss in turn below:

- Revenue, passenger number and flight number data from eight London and regional airports collected from various sources
- the ATRS Global Airport Benchmarking Report 2011, which surveys 156 airports worldwide, including 45 airports in Europe; and
- data obtained from easyJet and Ryanair about airport charges across their route portfolios.

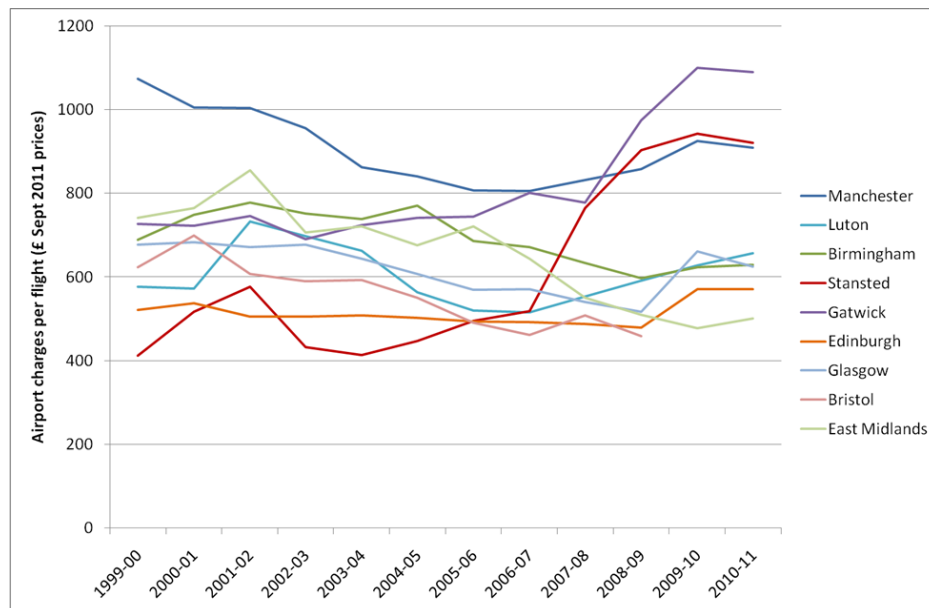
3.125 Figure 26 and Figure 27 below show the airport charges revenue per terminal passenger and per flight for eight UK airports. The charts show that between 2002 and 2007, Stansted was charging significantly below all the other airports for most of the period. Indeed, the period over which Stansted was (on average) the cheapest airport per passenger coincides with the period over which there were long-term pricing agreements at Stansted, including with Ryanair and easyJet. When these contracts expired, Stansted's prices increased.

Figure 26 Airport charges revenue per terminal passenger



Source: CRI, CAA data, airport annual accounts

Figure 27 Airport charges revenue per flight

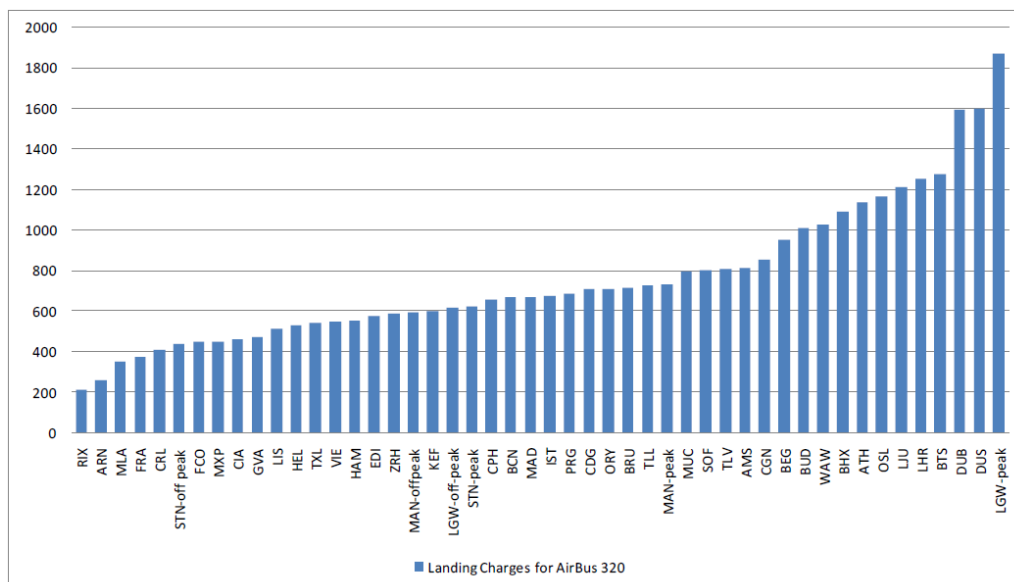


Source: CRI, CAA data, airport annual accounts

- 3.126 Stansted’s prices appear to stabilise in line with Manchester’s and below those of Gatwick’s. Looking at airport charges revenue per terminal passenger, Stansted’s prices lie below Manchester’s, whereas looking at revenue per flight, they are almost equal. While Manchester serves a greater mix of airlines than Stansted and offers both long- and short-haul flights, Stansted provides access to the London catchment area. It is perhaps in line with expectations that the two airports should have similar charges.
- 3.127 This comparison across UK airports appears to demonstrate that Stansted certainly has seen a significant increase in its average charges (on both bases), and that this increase has taken the airport’s charges to be above those at a number of other UK airports. However, this increase – particularly when viewed on a per passenger basis – appears to be an increase of Stansted towards the level of charges at comparable airports. The evidence does not support the view that the increase in charges from 2006 was an increase above the competitive price level.
- 3.128 Turning to the second comparison, this concentrates on larger international airports, and so is particularly relevant if the relevant comparators are considered to be large international airports, whilst the earlier comparison provides insight into Stansted’s comparability with other airports serving low cost carriers.
- 3.129 Given the heterogeneity of airports, particularly when comparing different types of airports across different countries, neither comparison will be conclusive regarding Stansted’s charges. However, this information may provide a useful indicator of whether or not Stansted’s charges are significantly above or below those of other airports that we might regard as useful comparators.
- 3.130 Figure 28 below shows the ranking of the European airports according to the combined landing and passenger charge elements of airport charges, for an

Airbus A320.⁷⁸ This analysis shows that Stansted's charges are below average, but are above a number of primary (and secondary) airports serving major European capitals, notably Fiumicino (and Ciampino). The analysis does, however, show that Stansted's charges are below those at a number of other potential comparator airports, such as Birmingham, Paris Orly, Munich, and Dusseldorf.⁷⁹ Stansted's "off-peak" charges (for the Winter period) are amongst the lowest in the list.

Figure 28 Combined Landing and Passenger Charges at European airports for A320, 2010 (in USD)



Source: Air Transport Research Society, Key Findings of 2011 ATRS Global Airport Performance Benchmarking project, highlights presentation

- 3.131 While using an A320 with just over 110 passengers per flight as a typical flight appears reasonable for full-service scheduled short haul airlines, it might be distorting the relative costs per flight for short haul charter and low cost airlines, given they transport a higher average number of passengers per flight. For example, easyJet uses predominantly A320-family aircraft with 156 or 180 seats, and its average load factor in 2010 was 87 per cent, which corresponds to an average number of passengers of 135 and 156.
- 3.132 Figure 29 and Figure 30 show that while Stansted has the peak landing charges for A320 aircraft that are well below the average (across the sample of airports) and has off-peak landing charges that are amongst the lowest. Stansted's passenger charges for international passengers are close to, but below, the mean across the group.

⁷⁸ It assumes an A320 with 150 seats and a 75% load factor, hence 112.5 passengers. Per passenger charges are doubled as charges are levied only on departing passengers. The "peak/off-peak" differentiation for Gatwick, Heathrow and Manchester appears to refer to a differentiation for different times of the day, whereas for Stansted it refers to a differentiation for different months of the year, with peak referring to April-October.

⁷⁹ These airports are not necessarily the 'secondary' airport serving the capital city (as Stansted does) but are airports that serve large cities that are not capital cities.

Figure 29 Landing charges for Airbus A320, 2010, Europe

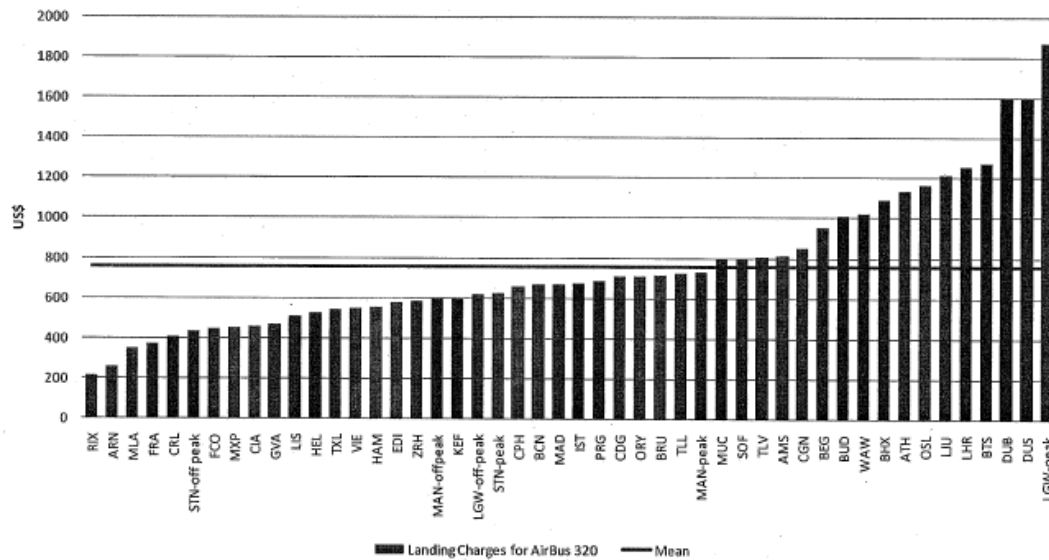
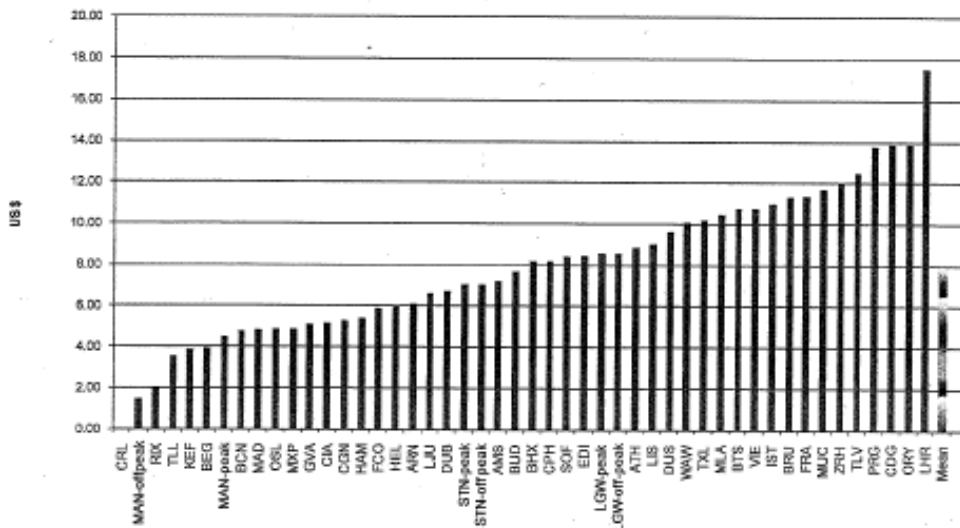


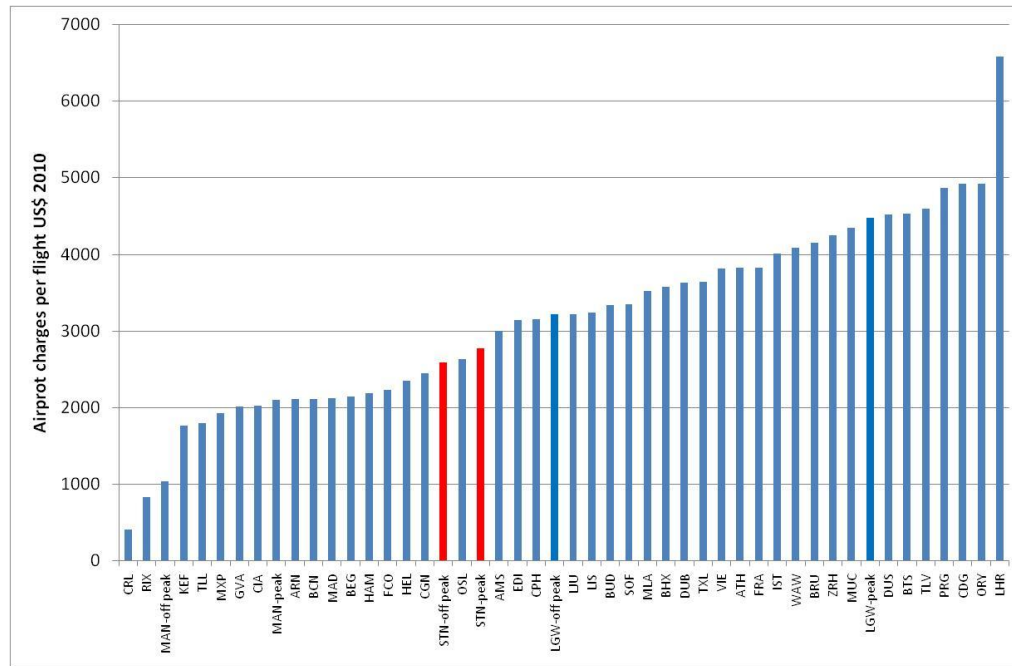
Figure 30 Terminal Charge per passenger on international flights, 2010, Europe



Source: ATRS Global Airport Benchmarking Report 2011

3.133 The report provides no combined passenger and landing charges for long-haul aircraft types but only the different landing charges. Whilst not directly relevant to the issue of the pricing faced by the airlines currently using Stansted, this analysis provides some useful context for understanding how the airport’s pricing to potential long-haul services compares to its peers.

Figure 31 Combined Landing and Passenger Charges at European airports for B767-400, 2010 (in USD)



Source: CAA calculations based on ATRS Global Airport Benchmarking Report 2011

- 3.134 Again, this analysis suggests that Stansted’s charges are close to, but below, the average level across the group of airports.
- 3.135 While a useful source of information, these data are based on published tariffs. However, in practice a number of airports might provide specific discounts to airlines, either based on volume or to incentivise the opening of previously unserved routes. Such discounts can significantly affect average per passenger charges an airline pays to an airport, and therefore it would be relevant to base any comparisons on actual charges paid by airlines.
- 3.136 EasyJet and Ryanair provided us data about the charges they pay to airports across their respective networks. They capture not only aeronautical charges (for landing, parking and passengers) but also charges for other services received from the airport, including for example check-in desk rentals.
- 3.137 Figure 32 shows easyJet’s charges across its network, together with the average level of charges across the network. Stansted and Gatwick are highlighted in red.

Figure 32 [X]

[X]

- 3.138 This analysis shows [X]
- 3.139 This analysis relies on the implicit assumption that the airports across easyJet’s network are reasonable comparators for Stansted. In contrast to Ryanair, easyJet has focused its network on serving larger destinations and airports that have good surface access connections. This suggests that this analysis is particularly useful if Stansted is viewed as comparable to large, but secondary, airports near to large cities and/or large holiday destinations.

3.140 Ryanair also provided price comparison data – in the form of indexed charges of airports across its network – [8]. This price comparison implies that – to the extent that Stansted should be compared to other airports serving predominantly no frills airlines – Stansted’s prices at the higher end of the spectrum.

Summary

3.141 Ryanair and, to a lesser degree, easyJet stress the flexibility of their business model, routinely vary their route mix and appear able to move capacity across their networks in the search of higher yields. The airlines, and in particular Ryanair, also account for a substantial share of the airport’s business. Whilst the two airlines no doubt face some costs associated with switching capacity away from the airport, the balance of available evidence supports the view that Ryanair, if not also easyJet, enjoys a degree of buyer power at Stansted.

3.142 However, at Stansted prices are negotiated on an airline by airline basis, which means that any buyer power enjoyed by Ryanair and easyJet would not protect the smaller airlines at Stansted and would therefore not be sufficient to constrain any market power at Stansted with respect to these smaller players.

3.143 Further, whilst think it likely that there is a degree of buyer power, it is not yet clear whether this would be sufficient to offset any market power found to be enjoyed by the Stansted over Ryanair and easyJet. To investigate this issue further we will need to consider the evidence available from both carriers on the yields available at Stansted and other airports, and will be looking for additional quantitative evidence to better understand the magnitude of switching costs at the airport.

Entry and expansion

3.144 The preceding section considered the responsiveness of airlines and passengers to changes in price, and whether these users would switch in sufficient numbers to an alternative existing airport to constrain the airport’s conduct. However, competitive constraints can also arise from entry and/or expansion of airports in Stansted’s market.

3.145 The impact of this form of competitive constraint will be limited by the magnitude of barriers to entry and expansion. These factors are considered below.

Barriers to entry and expansion

3.146 The CAA’s *Guidance on the Assessment of Airport Market Power* noted that barriers to entry in airport markets are particularly high and that expansion of existing airports is more likely to represent a competitive constraint on existing airports than the threat of entry by an entirely new airport. New airports can sometimes enter the market, but the investment and lead times involved in new entry are likely to significantly limit the impact of this form of competitive constraint.⁸⁰

⁸⁰ For example, Robin Hood Doncaster Sheffield airport opened in April 2005, and London City Airport opened in 1988.

3.147 Expansion and/or entry by existing aerodromes, and/or the threat thereof, may represent a source of competitive constraint. However, as with de novo entry, the cost and timescales involved in expanding to accommodate sufficient switching may still be too great to constrain Stansted's prices in the short to medium term.

Evidence of actual entry or expansion

3.148 One way to understand the nature of barriers to entry and expansion is to consider the history of entry and expansion in the market. There is very limited evidence of significant entry or expansion in Stansted's market. However, there are two recent examples of expansion in the form of Southend and the recent announcement of Luton's intention to increase capacity.

3.149 EasyJet recently struck a deal with Southend to transfer some of its flights from Stansted to Southend. As a result, Southend is upgrading its facilities and there is also an expectation that the rail link from London to the airport will be improved. It is possible that other airlines may begin operating out of Southend, following easyJet's lead, however any operations would be limited by Southend's runway specifications, which, for example, would not currently support Ryanair's fleet. EasyJet services from Southend are expected to commence in April 2012, and will contribute to a significant reduction in the easyJet services operating from Stansted going forward.

3.150 In addition, Luton's owners (Luton Airport Limited) have announced a process of consultation with a view to increasing capacity at the airport from circa 10.3 mppa to 18 mppa, although it is unclear at this stage whether and when such expansion might take place.⁸¹

3.151 In summary, while relatively small scale expansion is possible, the timescale required to achieve adequate expansion to accommodate sufficient switching is too long to constrain prices in the short term, but there is some potential for expansion projects that act to constrain pricing in the medium term at least (as illustrated by the Southend example).

Capacity constraints

3.152 The CAA's *Guidance on the Assessment of Airport Market Power*⁸² explained that scarce capacity can be a normal feature of a market and may not necessarily lead to market power and monopoly pricing. However, the underlying causes of scarce capacity might constitute significant barriers to entry and expansion. Where capacity constraints are caused by barriers to entry and/or expansion, they are likely to affect the strength of competitive constraints faced by an airport, and may give rise to market power held by incumbent airports, particularly where the barriers are non-transitory in nature.

3.153 The context of capacity constraints in the southeast and capacity constraints at the main London airports are discussed in the annex on capacity constraints.

⁸¹ For more information see, <http://www.futureluton.co.uk/optimisation.html>

⁸² 'Guidance on the Assessment of Airport Market Power', CAA, April 2011 (chapter 5)

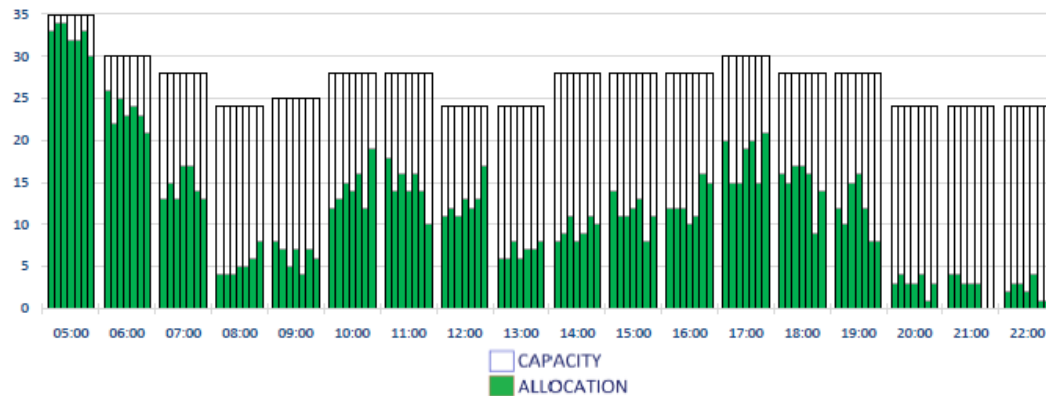
3.154 As Figure 33 below shows, Stansted has very limited spare capacity during a narrow peak period (with limited prospects for additional capacity at this time of day). However, it has ample spare capacity off peak through much of the day.

Figure 33 Stansted slot allocation, Summer 2011 and Winter 2001/2012

Summer

RUNWAY MOVEMENT ALLOCATION - DEPARTURES

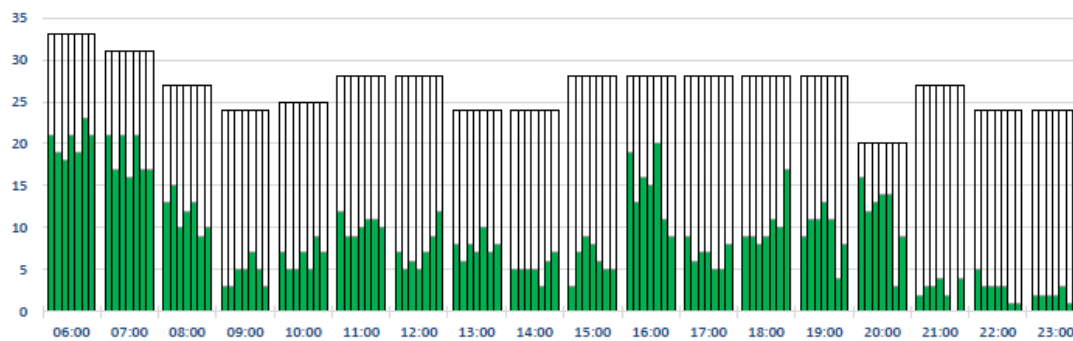
Peak Week Movements per Hour - All times UTC



Winter

RUNWAY HOURLY MOVEMENTS - DEPARTURES

Peak Week Movements per Hour - All times UTC



Source: ACL UK Start of Season Report Summer and Winter 2011

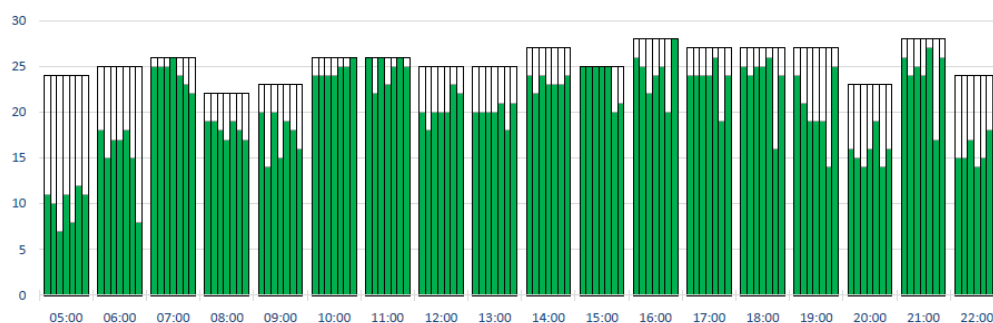
3.155 As discussed above, the major airlines at Stansted have argued that morning peak capacity is particularly important to the operation of based, low-cost aircraft.

3.156 As we identified above, the strongest local competitors to Stansted are likely to be Gatwick and Luton. As Figure 34 shows, Gatwick is capacity constrained. In particular, Gatwick is full through much of the day during the summer period and Gatwick is full during the peak morning period. This could potentially affect airlines' ability to switch to these airports at this time of day.

Figure 34 Gatwick slot allocation, Summer 2011

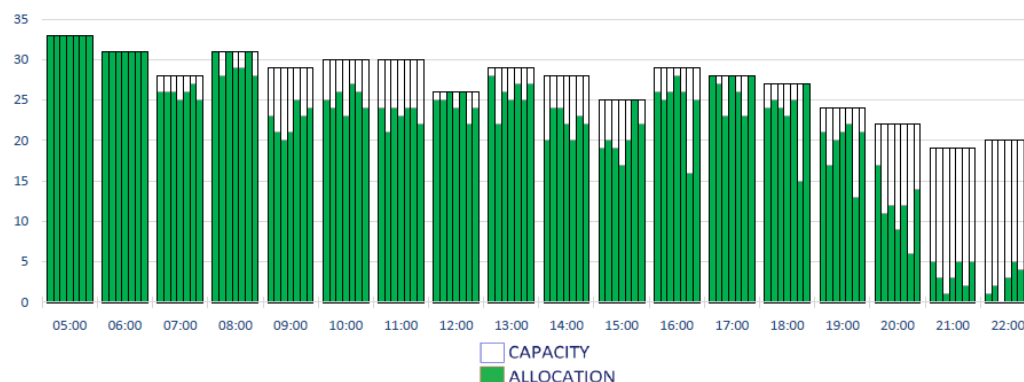
RUNWAY MOVEMENT ALLOCATION - ARRIVALS

Peak Week Movements per Hour - All times UTC



RUNWAY MOVEMENT ALLOCATION - DEPARTURES

Peak Week Movements per Hour - All times UTC



Source: ACL Start of Season Report, LGW Summer 2011

- 3.157 Overall, it is clear that there is significant capacity off-peak at Stansted, albeit that this might reduce over time, as demand grows. However, at peak times, there is very little spare capacity. The period over which these capacity constraints holds is currently somewhat limited, relating to 2 or 3 hours, but if demand grows these constraints would be likely to spread to other hours.
- 3.158 However, Gatwick notes that the airport “is exploring the possibility of declaring 55 movements per hour in peak periods, which is well above the levels currently being achieved by Stansted (which currently has only 50) or Luton”.⁸³ Gatwick also emphasises the spare capacity available, on both a passenger and ATM basis, across the London airports. In particular, Gatwick argues that – when comparing current traffic to potential capacity in 2020 – there is approximately 30 per cent spare ATM capacity and 40 per cent passenger capacity.
- 3.159 Overall, the evidence available suggests that the London airports are operating close to their capacity at peak times, albeit that steps may be possible at some of these airports to deliver additional peak capacity to the market. At this stage, it is not clear whether these capacity increases could be deployed in a sufficiently timely manner to discipline Stansted sufficiently at peak times. It is also relevant that demand is forecast to grow at the London airports, with this demand growth offsetting – to some degree – the potential for capacity to increase at peak times.

⁸³ Gatwick submission to the CAA, November 2011.

Pricing and behaviour

3.160 This section considers evidence from the pricing and behaviour of the airport, and how this might inform the assessment of the airport's market power.

Significant increase in price in 2006

3.161 In the CAA's *Guidance on the Assessment of Airport Market Power*, it stated that it agreed with the OFT's statement that "where prices are likely to differ substantially from their competitive levels, caution must be exercised when dealing with the evidence on switching patterns as such evidence may not be a reliable guide to what would occur under normal competitive conditions."^{84,85} It can, therefore, be important to understand how prevailing and historical prices relate to the competitive price level.

3.162 Stansted entered into a number of long-term contracts with its major airline customers, following the aviation downturn after 11 September 2001. These contracts were struck at prices that were substantially lower than the prevailing price cap, with some as low as [X] (compared to the current price cap of around £6.50). When these contracts expired, mostly during 2006, the average prices paid by the major airlines at Stansted increased substantially. This increase in prices paid was significant and did not appear to result in a sufficient reduction in use of the airport to render it unprofitable for the airport. This has been cited by airlines at Stansted as evidence that the airport enjoys SMP.

3.163 However, the interpretation of this price rise depends upon whether the price rise is viewed as an increase above the competitive level or an increase towards the competitive price level. This is important, as the latter would not be expected to generate a particularly strong response from customers, whereas a rise above the competitive level should elicit a strong response at a competitive airport; the absence of which would be particularly strong evidence of market power.

3.164 It is difficult to establish with precision whether prices were at 'competitive' levels or whether the current levels are now close to these levels, but the following provide some evidence:

- There are some indications that some of the 2001 contract prices were very low. Indeed, the prices have not been sufficient for the airport to earn the allowed return on its regulatory asset base for an extended period, and it is not forecast to do so in the near future.
- In contrast, and as discussed in paragraph 3.136, Ryanair has argued that Stansted now has the highest charges across its network, other than Gatwick and Dublin, providing supporting evidence for this view. Evidence from easyJet is more mixed, indicating that the airport is approximately 'mid table' across its network.

⁸⁴For example, product markets could be defined excessively broadly on the basis of the prevailing price level if this is above the competitive level due to pre-existing market power of the undertaking(s) in the market. This is referred to as the Cellophane Fallacy, after the case *US vs. El Du Pont de Nemours & Co* [1956] 351 US 377.

⁸⁵OFT *Market Definition* guideline (OFT403) paragraph 5.6.

- 3.165 As discussed in paragraph 3.123, the weighting of this evidence depends upon the view taken of the appropriate comparator airport for Stansted: should it be compared to UK and European regional airports supporting LCC operations; or is the appropriate comparison larger airports, reasonably connected to large cities, with a mix of LCCs, LCCs and long-haul operations? The former view might suggest that the 'competitive' price at Stansted would not remunerate many of the assets at the airport, certainly not until the airport faces higher demand relative to available capacity, which might suggest this is not a normal or sustainable price level. However, these are the prevailing market conditions for a lot of the LCC sector.
- 3.166 It appears appropriate for a competitive airport both to discount significantly where there is spare capacity but also to have the freedom to increase charges and recoup the costs of efficient investment during peak periods. Given that there is stronger demand at peak times, this implies that the airport might be expected to increase charges at these peak times – something that the current price control allows, so long as charges in off-peak times are sufficiently low so as to bring the average charges below the price cap.
- 3.167 This suggests that even if there was a case to 'write-down' the assets at Stansted (to better reflect those needed at a no-frills airport) by a very significant amount – and, say, to halve average charges – it could be argued that an such an airport would still be acting reasonably by loading the recovery of this lower asset base towards peak periods. With only two of 18 hours facing constraints, this allocation of asset costs to peak might readily counter-act even an aggressive write-down of Stansted's asset base, and support the view that the current (peak) prices are reasonable given the market circumstances.
- 3.168 More generally, whilst the airport has set its published charges close to the price cap, it has the ability to increase peak charges above the level of the price cap. However, Stansted has not chosen to set its charges in this way. This lack of peak/off-peak pricing throughout the day might support the view that the airport cannot sustain a price increase at these peak times, for fear of the airlines at peak switching away from the airport. An alternative explanation might be that the airport is concerned about the potential for the customers using peak capacity to challenge the airport's freedom to increase charges in this way. The latter explanation might be consistent with the view that the major airlines at Stansted enjoy a degree of buyer power.

Reduction in traffic

- 3.169 In 2010, 18.6 million passengers travelled though Stansted, this is a reduction of 7 per cent on 2009 passenger numbers and brings Stansted back down to 2003 levels. This significant reduction in airline use of the airport follows the increase in charges at the airport, but also coincides with a recession in the UK, and low levels of GDP growth across Europe. Consequently, the reduction in traffic at Stansted could either reflect economic trends or price responsiveness.

3.170 Ryanair says that the fall in traffic at Stansted is not due to the economic downturn, arguing that it and easyJet have expanded elsewhere despite the downturn. Ryanair says that the fall in traffic is as a result of Stansted failing to offer sufficient discounts. This shows that airlines do have a choice of where to expand and at least some ability to switch away when Stansted's relative prices go up.

Stansted's efforts to attract new business

3.171 The reduction in traffic at Stansted has resulted in ample spare capacity off-peak (at least 10 useable slots in each hour). It might be expected that the airport would be offering aggressive discounts for growth, in an attempt to generate some revenue from this capacity.

3.172 As noted above, Ryanair, in particular, has argued that this is not happening and that Stansted's charges are out of line with UK and European comparator airports. However, the CAA has seen both growth contracts offered to Ryanair at other UK airports and examples of the offers made by Stansted to other airlines for growth. The level of discounts offered by Stansted appear – on the face of it – to be substantial [REDACTED].

3.173 Nevertheless, these offers have not been sufficient to attract growth, or to retain the current traffic at the airport. [REDACTED]

3.174 [REDACTED]

3.175 These views would tend to suggest that the presence of Ryanair at the airport has the effect of discouraging other airlines with a similar business model from operating at the airport. To the extent that this reduces the ability of the airport to attract new carriers it would limit the airport's market power (certainly off-peak) and might compound the bargaining strength enjoyed by Ryanair.

3.176 However, this does not appear to explain all of the apparent reluctance to use the airport, as Air Asia X would not obviously be concerned about Ryanair's short-haul operations [REDACTED]. Clearly, there are other factors that make Stansted less attractive to Air Asia X (and by extension perhaps to other carriers). [REDACTED]

3.177 Overall, the evidence provided by Stansted appears to support the view that it is offering 'competitive' discount offers to support growth in off-peak periods. Indeed, the evidence currently available supports the view that there is no SMP relating to the off-peak periods.

Evidence of market power at peak

3.178 In general, the balance of available evidence implies that airlines at Stansted have a choice of airports to switch to, facing limited switching costs other than any loss in revenue associated with the switch.

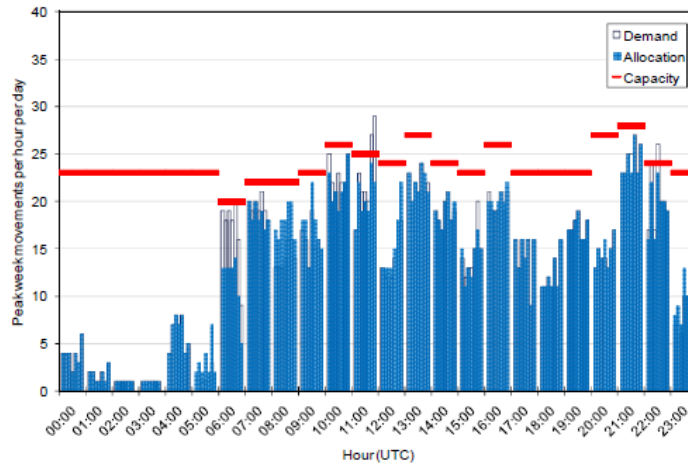
3.179 However, Chapter 2 identified the importance of morning departure slots for based aircraft for the airlines at Stansted. In order to make best use of their aircraft, this type of airline must depart early in the morning to ensure sufficient rotations of the aircraft.

- 3.180 As shown above, reflecting the importance of these peak slots, Stansted is capacity constrained during the morning peak. Similarly, Luton and Gatwick are also constrained at this time. This lack of capacity at this crucial time of day may make switching based aircraft more difficult.
- 3.181 Nonetheless, switching may take place, but it is likely to be more costly to obtain slots at this time. [X]
- 3.182 In Chapter 2, it was concluded that the geographic market for airlines at Stansted was likely to be European wide. We must therefore also consider the capacity of other European airports during the peak time. So far we have only limited evidence on this, which is drawn from publicly available information.⁸⁶ However the following charts show that it is common for these other European airports to also be constrained at peak.
- 3.183 This evidence implies that airlines may find it difficult to switch away from Stansted during the peak morning hours, suggesting that Stansted could have market power over these airlines at this time. At this stage we do not have sufficient evidence to conclude whether Stansted has significant market power and will be seeking further data in order to be able to carry out analysis on this issue.

⁸⁶ 'Impact Assessment of revisions to Regulation 95/93 – Final Report', European Commission, March 2011

Figure 35 Dublin, Summer 2008, slot demand and allocation

S08 Arrivals:



S08 Departures:

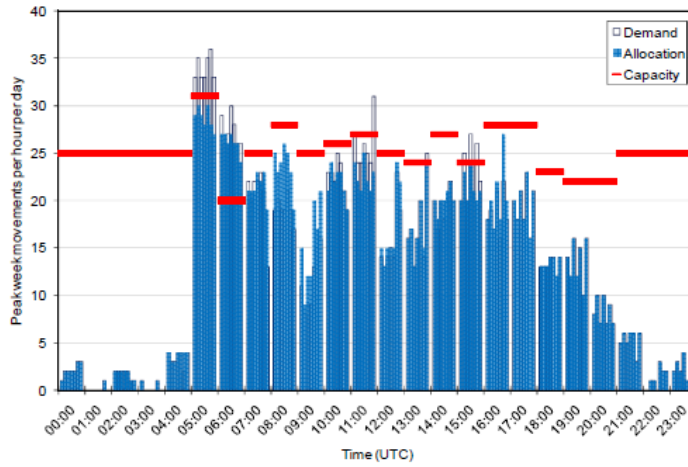
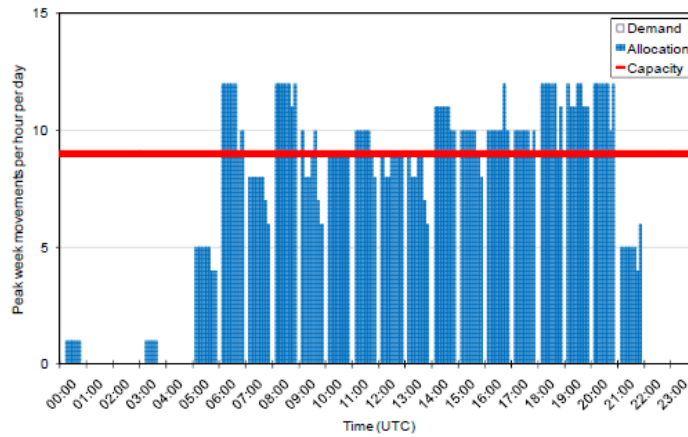


Figure 36 Milan Linate, Summer 2008, slot demand and allocation

S08 Arrivals:



S08
Departures
:

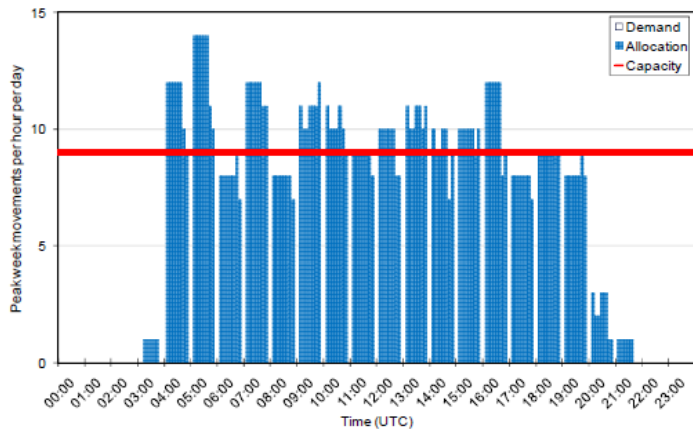


Figure 37 Rome Fimucino, Summer 2008, slot demand and allocation

S08
Arrivals:

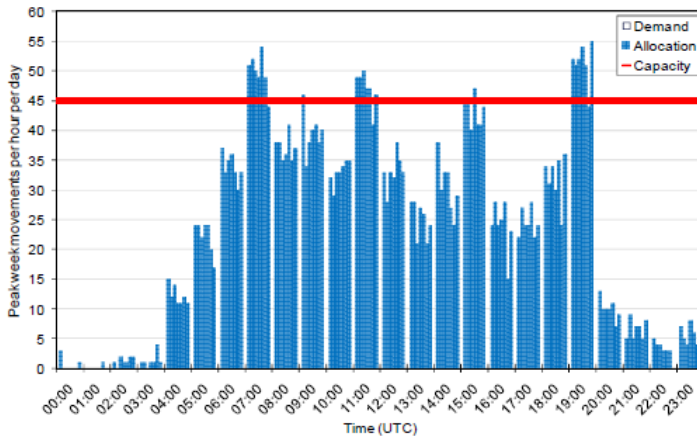
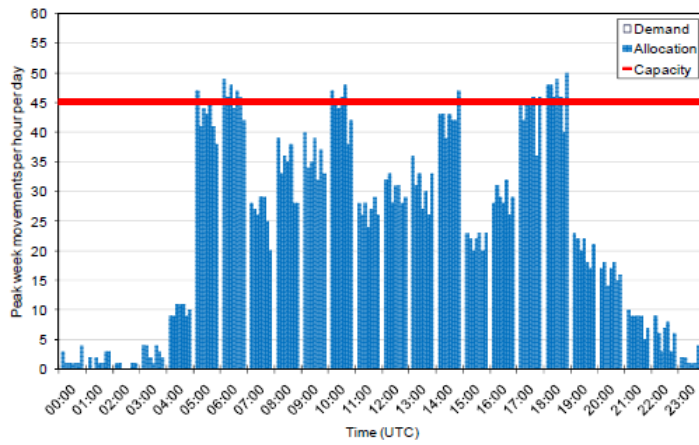
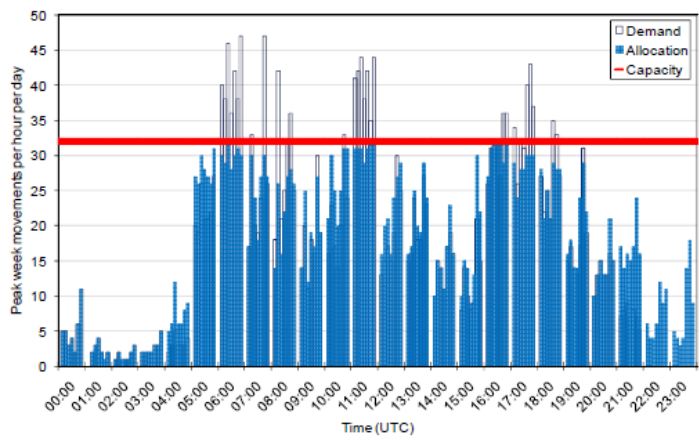


Figure 38 Palma Mallorca, Summer 2008, slot demand and allocation

S08 Arrivals:



S08 Departures:

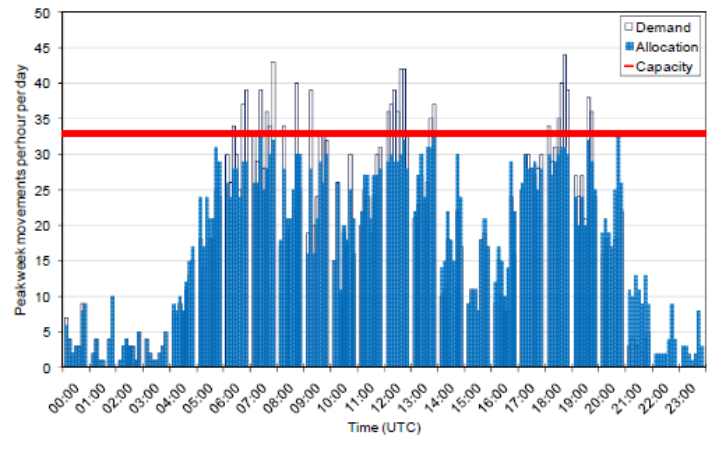
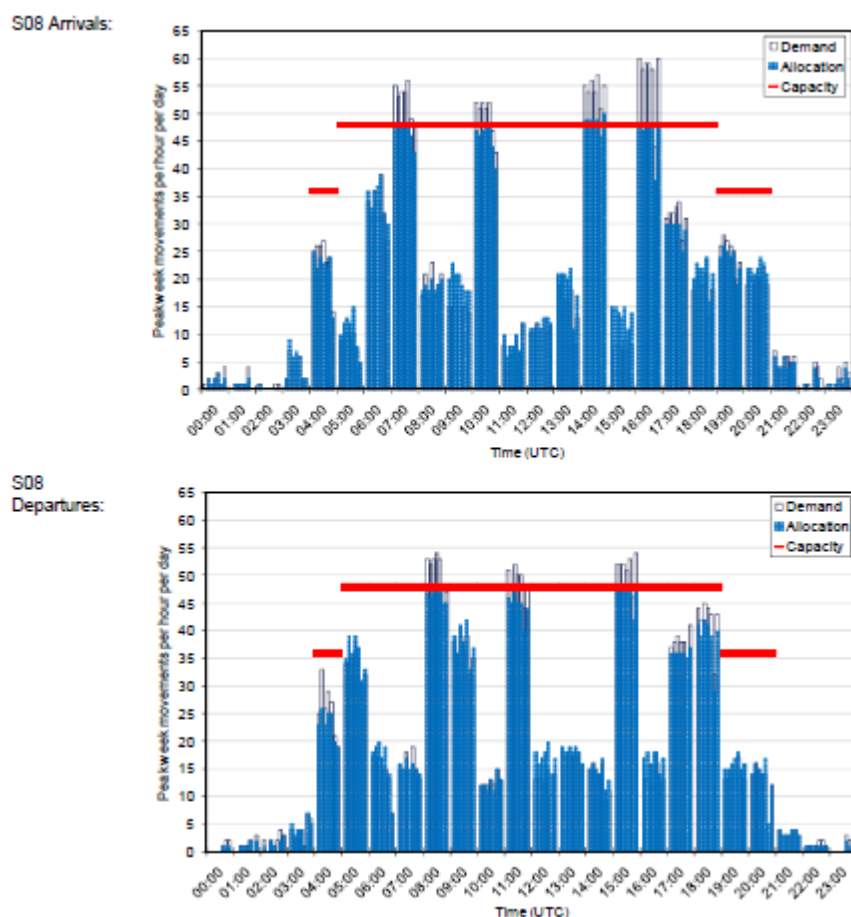


Figure 39 Vienna, Summer 2008, slot demand and allocation



3.184 It could be argued that if Stansted had market power during the peak period, we should see higher prices during this time period. Stansted offers significant discounts off-peak so theoretically it could put prices up at the peak without exceeding the cap. As discussed above, Stansted does not charge higher prices during the peak, which might suggest that the airport is unable to increase charges above the current level.

Financial performance

3.185 Stansted is subject to price cap regulation, which is designed to prevent airports from earning excessive returns. Consequently, analysis of the financial performance of these airports is unlikely to provide particularly strong evidence about their market position, particularly if the airports choose to set their prices at, or near to, the allowed price cap – something which Stansted is now doing.

Impact of common ownership with Heathrow

3.186 As noted above, Stansted and Heathrow are still currently under joint ownership. The discussion of market shares highlighted that, whilst Stansted's market shares were generally not particularly high, when the combined position of Stansted and Heathrow is considered the market shares are sufficiently high as to adopt a rebuttable assumption of dominance.

3.187 As discussed in the Competition Commission's (CC) inquiry into BAA's ownership of UK airports, the effects of joint ownership could take a number

of forms. The CC also concluded that the joint ownership of Stansted and Heathrow inhibited competition to such a degree that there is a case for the divestment of Stansted by BAA.

- 3.188 It could, therefore, be argued that Stansted's competition for airlines and/or for passengers is muted by concerns about the adverse impact on Heathrow. Stansted disputes this view and argues that any transfers of passengers from Heathrow to Stansted would quickly be back-filled as a result of the strong underlying demand at Heathrow, making BAA neutral to Stansted's competition with Heathrow.
- 3.189 However, there is a marked contrast between the aggressive marketing of Heathrow and Gatwick to passengers and the relatively low-key approach adopted by Stansted, which could be explained by the continued ownership by BAA. Indeed, there is some anecdotal evidence that Stansted scaled-back its marketing efforts [X].
- 3.190 Of course, even if joint ownership were reducing the ability of Stansted to compete, this is not sufficient to conclude that divestment by BAA would be sufficient to remove any SMP held by the airport. Rather, that divestment would lead to a more competitive outcome than continued joint-ownership. Separate ownership may be necessary, but it is not sufficient
- 3.191 Ownership appears likely to change in the near future and the impact of this will depend on the new owner. This may address concerns on incentives to compete for traffic. However, it is unlikely to be in sufficient time to provide compelling evidence on behaviour before a decision on market power is made.

Cargo

- 3.192 Whilst Stansted has a strong position in cargo-only flights, we consider it likely that the geographic market for cargo-only operations is likely to be very broad, and to be UK-wide (if not wider). Further, Stansted's shares of these markets do not give rise for particular concern.
- 3.193 However, given the size of Heathrow, when Stansted and Heathrow are considered together, BAA has a very substantial share of UK cargo and – through Stansted – a significant share of cargo-only operations.
- 3.194 At this stage, the CAA has not undertaken sufficient analysis to reach any firm conclusions in respect of cargo at Stansted, and has not received any evidence relating to cargo operations.
- 3.195 Reflecting this, we invite contributions from stakeholders and will continue our work in this area during 2012.

Long term view

- 3.196 Stansted's market power will, inevitably, vary over time, as its circumstances change. In this section we consider the factors that appear likely to affect the airport's future market power.
- 3.197 We discuss the following developments and how they might affect Stansted's market power:

- Demand growth and capacity constraints;
- The sale of Stansted; and
- The potential growth of long-haul at the airport.

Traffic forecasts and capacity constraints

- 3.198 The DfT regularly produces long term passenger forecasts for UK airports. Its latest forecasts published in August 2011 predict that absent any further runway expansion by 2030 Heathrow, Gatwick and Stansted will be operating at full capacity, suggesting there will be excess demand for these three airports.
- 3.199 Increasing capacity constraints at Stansted and its competitors could suggest higher switching barriers for passengers and airlines and therefore a higher level of market power: There would be less scope for airlines at Stansted to switch to other airports, and excess demand suggests that switching would have limited effects on the airport as any vacated slots would be taken up by other airlines.
- 3.200 However, in response to tightening capacity at the three largest London airports, it is possible that other airports, including Luton and neighbouring regional airports, might emerge as more credible competitors by developing their infrastructure and service offering. Indeed, Stansted is facing the prospect of expansion from Southend in 2012, which is expected to have a direct adverse impact on volumes at Stansted, as easyJet relocates capacity between the two airports. During 2012 additional information will be available about the initial success of this expansion plan, as traffic statistics emerge.
- 3.201 Further, the owners of Luton Airport have announced plans to increase capacity at the airport, taking the airport towards a passenger capacity of 18 mppa. These two events could lead to a significant increase in the availability of capacity to compete with Stansted – at two airports with strong catchment overlaps with the airport – albeit that there is a degree of uncertainty attached to the success of both projects.
- 3.202 More generally, and over the longer term, a range of other regional airports might emerge as stronger alternatives to Stansted, and the other London airports, as capacity constraints provides a commercial case for expansion at these airports. For example, Birmingham was recently discussed in the press as a potentially viable alternative to the large London airports. LCC operators might also find it more profitable to move any traffic growth increasingly to other geographic areas across Europe.
- 3.203 However, even with growing capacity constraints, the London airports, in separate ownership, might still find it profitable to compete for marginal users, for example by inducing airlines to use larger aircraft and passengers with higher retail spend to use their airport instead of their competitors.
- 3.204 In summary, whilst there is a degree of uncertainty, it appears likely that capacity constraints are unlikely to ease over time and that demand growth will tend to increase Stansted's market power, albeit that there are projects that might – if successful – act to erode this position.

The potential sale of Stansted by BAA

- 3.205 Following the recent decision at the Competition Appeals Tribunal, the CC's decision to require BAA to sell Stansted Airport remains in effect, and it appears increasingly likely that in the near future Stansted will be sold by BAA.
- 3.206 In the CAA's assessment of Gatwick's market power, we discuss the noticeable impact that the sale of Gatwick had on the airport's behaviour. We consider that it would be reasonable to expect a similar development following the sale of Stansted. Although the precise impact of the sale is difficult to predict, we would expect the airport to have greater freedom to innovate in terms of its service offering and in its commercial arrangements with airlines. For example, the airport might market itself more aggressively and identify ways for it to distinguish its offer (to a greater degree) from that available at Luton, Gatwick and Heathrow.
- 3.207 More generally, the sale of Stansted would remove concerns about the airport's incentives to compete for airlines and passengers, and remove the relevance of combined Heathrow-Stansted market shares from the above analysis. It is difficult to assess the impact of ownership change at this stage, and it will no doubt be difficult to assess the conduct of an independent Stansted for some time (due to the limited information available about its conduct), there is a reasonable prospect that divestment would have a significant impact on the airport's market power.

Potential growth of long-haul at the airport

- 3.208 Much of the analysis in this paper focuses on the relationship between Stansted and LCCs operating short-haul services. However, the airport can accommodate large, long-haul operations. As we note, there is evidence that the airport has been seeking to attract these services, as yet without success.
- 3.209 To the extent that the airport successfully attracts significant long-haul operations to the airport, we would expect to update the analysis, and broaden the focus to include, for example, market definition that covers long-haul operations. We have not, however, identified any reason why the growth of long-haul operations at Stansted would have a significant impact on the airport's market power.

Overall assessment of market power

- 3.210 This final section presents a summary of the factors that appear to contribute to Stansted's overall market position. It considers evidence on market shares, airline switching, passenger switching and the airport's behaviour, before presenting an overall conclusion.

Market shares

- 3.211 Market shares can provide an indicator of an airport's market position. Even under the narrowest definition, when we limit the market to be short haul flights from the London area, Stansted does not have a high market share, when viewed as a stand-alone airport, and certainly below the level at which there would be a rebuttable presumption of dominance. However, Stansted

and Heathrow are both currently owned by BAA, and combining the market shares of the two airports gives very high market shares and which on a UK-wide basis are still as high as 58 per cent.

- 3.212 An important aspect of understanding market power at Stansted is to consider the position of the airport at the early morning peak. Looking only at peak periods increases Stansted's market share to 26 per cent (behind Heathrow and Gatwick's 30 per cent), and a combined share with Heathrow of 56 per cent. On some measures, the combined share of BAA-owned airports would support a rebuttable presumption of dominance.

Airline switching

- 3.213 The predominant airline business model at Stansted is low-cost, short-haul, point-to-point. In general, these airlines will have invested less at the airport than other airline business models, have multiple bases across the UK and Europe and, due to their more streamlined cost structure, face airport charges that generally account for a bigger proportion of the total costs than they do for full-service network airlines. This implies that there will be a greater incentive, and more ability, for low cost point-to-point airlines to switch in response to a given increase in airport charges, which is consistent with evidence that highlights that the major carriers at Stansted operate particularly dynamic networks, with the routes flown varying to a significant degree over time.
- 3.214 Even if switching costs are low enough to allow airlines to switch, they must have appropriate alternative airports to switch to. A based carrier at Stansted's ability to switch to neighbouring airports may be limited by constrained capacity at other London airports, but those airlines with a network of bases across Europe also have the option of switching to other, non-London airports.
- 3.215 The likely magnitude of switching costs, and the sensitivity to airport charges, is mirrored by the evidence of airline switching. In recent months, Stansted has lost several major airlines to Gatwick (Norwegian, Air Berlin and Air Asia X), despite their being some capacity constraints at Gatwick. In addition, easyJet has recently announced its intention to move some of its based aircraft from Stansted to Southend.

Passenger switching

- 3.216 We have considered a range of evidence to understand the extent to which passengers might switch between airports. Analysis based on airport catchment areas highlights the significance of catchment area overlaps, particularly over the most densely populated areas (notably Greater London). This suggests that a significant proportion of passengers are likely to be marginal, and able to switch away from Stansted, if a suitable service is available at an alternative airport.
- 3.217 Survey evidence is consistent with this general finding, showing that there are significant numbers of Stansted passengers who have previously used another London airport (indicating a degree of willingness to travel to use

these airports) and that stated that they had considered alternative airports to Stansted. This is consistent with the survey results that indicated a higher degree of price sensitivity at Stansted and Gatwick, when compared to Heathrow.

3.218 However, this apparent willingness to switch between airports relies upon passengers being able to find a suitable service at an alternative airport. In this respect, whilst Stansted has fewer route overlaps than other London airports, 74 per cent of passengers at the airport could fly to their chosen destination from another London airport. This suggests that a large proportion of passengers are likely to have the willingness and ability to switch away from Stansted.

3.219 Further, as only around 10 per cent of Stansted's passengers were on regularly-served routes served by more than one airline at Stansted, it is likely that should an airline remove a service from Stansted, the airport would be more likely to lose the passengers from that route to another airport. Indeed, the interplay between passenger and airline decisions means that the loss of business to an airport resulting from an increase in price may be greater than indicated by the impact on 'marginal' passengers, as services become unprofitable and prompt those who would have used these services to consider using another airport.

Airport sensitivity to airline and passenger switching

3.220 In order to understand the impact that passenger and airline switching is likely to have on the airport, it is useful to consider the volume reduction (or 'critical loss') that would render an increase in prices unprofitable. CAA calculations suggest that to render a 5 to 10 per cent price rise unprofitable the airport would need to experience a fall in passenger numbers of between 3 and 11 per cent, depending on the assumptions used. For example, if the price increase applies to the airports overall revenue, a 5 per cent increase would be rendered unprofitable if the airport lost approximately 900,000 passengers, or approximately 1,000,000 passengers if operating costs are saved as passenger numbers fall.

3.221 EasyJet commissioned Frontier Economics to analyse the potential for airline switching to constrain prices at Stansted, undertaking similar calculations to those set out above. Frontier's paper shows that airlines switching and passenger switching would be insufficient to render a 10 per cent increase in charges unprofitable. However, whilst this analysis makes a useful contribution to the available evidence, the approach taken restricts passenger and airline switching in a number of ways that are likely to under-state the actual level of switching. In addition, the data made available to Frontier introduces a further potential source of bias, in that it is based on average easyJet route profitability, rather than the profitability of the most marginal services.

Buyer power

3.222 Ryanair and easyJet account for a very large proportion of passengers at Stansted, with 68 and 21 per cent shares respectively. Further, whilst

Stansted is no doubt an important base for both airlines, the airport accounts for a much lower proportion (17 and 8 per cent) of the airlines' passengers. This implies that Stansted is significantly more reliant on Ryanair and easyJet than these airlines are reliant on the airport, and that there could be a degree of buyer power at the airport.

- 3.223 Analysis undertaken for Ryanair by RBB disputes the view that there is a degree of buyer power at the airport. The RBB paper cites the evidence of actual switching that took place following the increase in airport charges faced by Stansted when its agreements with the airport expired, emphasises the importance to buyer power of having an ability to switch, and also argues that there are significant costs to Ryanair relocating aircraft across its European network. Whilst we agree that buyer power requires the combination of scale with the existence of an ability to switch away from the airport, we consider it likely that both Ryanair and easyJet have the ability to switch volumes away from the airport. Indeed, the significant number of bases operated by the two airlines, and recent examples of the airlines opening new bases – including the example of easyJet's switch to Southend – highlights that there is a significant degree of potential switching from these two airlines.

Competitive price level

- 3.224 The interpretation of the evidence on airlines' historical responses to price increases is affected by the relationship between historical prices and the competitive price level. This is particularly important in light of the very significant increase in prices paid at the airport during 2006 and the relatively moderate reductions in volumes that followed.
- 3.225 In order to understand whether these price rises were increases towards, or increases above, the competitive price level we have considered a range of sources of evidence.
- 3.226 Ryanair provided evidence that showed that its charges at Stansted are considerably higher than at many of the other airports it operates from. However, when Stansted's average charges are compared to those at comparator airports, it reveals that the level of historical charges was particularly low and that the recent price levels are broadly in line with a number of potential comparators. On balance, it appears that the increase in charges around 2006 was an increase towards, rather than above, the competitive price level – in which case, we would not expect there to have been a particularly significant response from airlines switching away from the airport.

Entry and expansion

- 3.227 Expansion and/or entry by existing aerodromes may represent a source of competitive constraint, albeit one that is limited by the cost and timescales involved. However, there is relatively limited evidence of significant expansion and/or entry in Stansted's market, with the notable exception of the planned easyJet expansion at Southend Airport, which involves a relocation of capacity from Stansted to Southend.

3.228 At the time of writing, plans are also being discussed for the expansion of Luton Airport.

Capacity constraints

3.229 It is clear that there is significant capacity off-peak at Stansted, albeit that this might reduce over time, as demand grows. However, at peak times, there is very little spare capacity. The period over which these capacity constraint holds is currently somewhat limited, relating to 2 or 3 hours, but as demand grows these constraints would be likely to spread to other hours.

3.230 Capacity constraints at early morning times appear to be a feature at Luton, Gatwick and a number of other European airports. This lack of early morning capacity might reduce the ability of airlines to relocate operations from Stansted, although Gatwick – which is relatively full by European standards – has been able to accommodate a number of new airline services, including a number of services switching from Stansted.

Pricing and behaviour

3.231 As discussed above, evidence from Ryanair and from other sources paints a somewhat different picture about the appropriateness of Stansted's current prices. However, in general terms, the available evidence tends to support the view that the current price level is reasonable. It is also notable that the airport has flexibility to raise its prices at peak times but has chosen not to do so.

3.232 The airport has, however, seen a considerable fall in passenger volumes, falling below 18 million, which is back down to 2003 levels. This significant reduction in airline use of the airport follows the increase in charges at the airport, but also coincides with a recession in the UK, and low levels of GDP growth across Europe. Consequently, the reduction in traffic at Stansted could either reflect economic trends or price responsiveness. In this respect, Ryanair says that the fall in traffic is as a result of Stansted failing to offer sufficient discounts, which arguably implies that airlines do have choices of where to expand and at least some ability to switch away when Stansted's relative prices go up.

3.233 We have also considered whether the airport has responded to the reduction in traffic, and the availability of substantial capacity off-peak, by offering aggressive discounts for growth. The evidence provided by Stansted appears to support the view that it is offering 'competitive' discount offers to support growth in off-peak periods.

3.234 Overall, the evidence currently available supports the view that there is no SMP relating to the off-peak periods.

Evidence of market power at peak

3.235 Capacity in early morning periods appears to be particularly important for the low-cost carriers at Stansted. There are capacity constraints at these peak periods at Stansted and also at Luton and Gatwick. This lack of capacity at this crucial time of day may make switching based aircraft away from Stansted more difficult.

- 3.236 Nonetheless, switching may take place, but it is likely to be more costly to obtain slots at this time. [36]. Airlines are generally able to obtain the slots they want through slot trading, albeit that the slots at the more popular times are likely to be more expensive.
- 3.237 Overall, there remains significant uncertainty about the balance of negotiating power at peak periods, with the incumbent airlines at Stansted placing particular weight on capacity at these times, whilst there are also constraints at a number of alternative airports. Set against this is the general flexibility of the business models of the airlines that use Stansted at peak periods, and the fact that the airport is not currently exercising its ability to increase prices in these periods.
- 3.238 On the evidence currently available, Stansted's market power at peak periods could amount to a position of SMP. In order to investigate further this aspect of Stansted's market position, we expect to seek additional information on airline switching costs, including on the impact that route profitability might have on these switching costs.

Impact of common ownership with Heathrow

- 3.239 As noted above, Stansted and Heathrow are still currently under joint ownership. It could therefore be argued that Stansted's competition for certain airlines is muted by concerns about the adverse impact on Heathrow. Stansted disputes this view and argues that BAA is neutral to Stansted's competition with Heathrow.
- 3.240 However, we consider that there is a marked contrast between the aggressive marketing of Heathrow and Gatwick to passengers and the relatively low-key approach adopted by Stansted, which could be explained by the continued ownership by BAA.
- 3.241 Of course, even if joint ownership were reducing the ability of Stansted to compete, this is not sufficient to conclude that divestment by BAA would be sufficient to remove any SMP held by the airport. Rather, that divestment would lead to a more competitive outcome than continued joint-ownership.

Initial view on the degree of Stansted's market power

- 3.242 At this stage, the supply of capacity at peak times is the most likely source of any position of substantial market power at the airport, albeit that we remain concerned that BAA's ownership of Heathrow and Stansted could be reducing the ability of the airport to raise its profile and adopt aggressive strategies to attract passengers and airlines to the airport.
- 3.243 There is, however, a lack of clarity about the ability of airlines to reduce their use at peak times, and the evidence on pricing at these times. First, peak capacity appears important to the airlines at Stansted, as it supports the efficient use of their aircraft, making them reluctant to reduce their use of peak capacity. This, however, needs to be set against the apparent flexibility of their business models, which might enable switching to alternative airports.
- 3.244 Second, we have seen evidence that supports the view that Stansted's prices, whilst higher than a number of airports across Europe, appear comparable to

those serving major conurbations. Furthermore, Stansted does not currently price discriminate between different times of day, despite having the ability to do so.

3.245 Looking forward, the CAA's view on the market power at Stansted will likely depend upon the following:

- The evidence available on the barriers to airlines reducing their use of Stansted at peak times, including the impact on airline yields; and
- Whether, and to whom, the airport is sold by BAA.

3.246 Whilst the second of these factors is outside of the control of the CAA, we would hope to be able to work with airlines and the airport to obtain better information to reach a firm view on the former.

3.247 Overall, therefore, we see Stansted as enjoying the least market power of the three airports being assessed and, whilst the evidence is currently not sufficiently clear to reach a definitive view, it appears that any position of substantial market power arises from the relative bargaining positions of the airport and airlines during a relatively narrow peak period. The relative strength of these positions might change over time and be affected by the potential ownership changes at the airport, as well as the balance between demand and available capacity.

