



Airport market power assessments *Update and emerging views*

Stakeholder workshop
15 November 2011

Session objectives and content



- **Objectives:**

- Explain the arguments that appear likely to be particularly important to the CAA's assessment of airport market power
- Invite stakeholders to offer views on these arguments, prior to the CAA reaching its initial assessment
- ➔ *We will not be setting out all of the evidence and analysis in full*
- ➔ *We will not be exploring the implications of any particular finding for the form of the Q6 price control*

- **Contents:**

- Background and process
- Approach to analysis
- LHR
- LGW
- STN
- Next steps

The role of market power assessments



- **Q6 Airport price controls**
 - Economic regulation is a remedy to high levels of market power
 - Market power assessments help to inform how regulation might best match the nature and level of market power at each airport
- **Airport Economic Regulation Bill**
 - Government has announced its intention to introduce a licence-based framework for economic regulation
 - Airports will attract an economic licence if they meet a number of conditions, related to their market power
- **Section 41**
 - CAA's analysis of complaints under section 41 is informed by competition law principles

Process



15 November	Stakeholder seminar
30 November	Deadline for submissions to the CAA to be included in initial assessment
December	CAA assessment
Early January	CAA publishes initial assessment
Early March	Deadline for comments on the initial assessment
April	Q6 Airport Price Controls – Update

Format of today's presentation



- **For each airport, we will present the arguments that appear to:**
 - Support the view that the airport has market power
 - Support the view that the airport faces competitive constraints
- **We will highlight which arguments we see as particularly important to the overall assessment**
- **We will discuss what might affect the assessment in the process leading up to the Q6 decision, including:**
 - The role of additional analysis and evidence
 - Possible changes in the market context
- **We have not:**
 - Presented all of the current evidence
 - Organised the material into formal market definition / market power assessments

What is market power, and what questions are we seeking to answer to assess it?



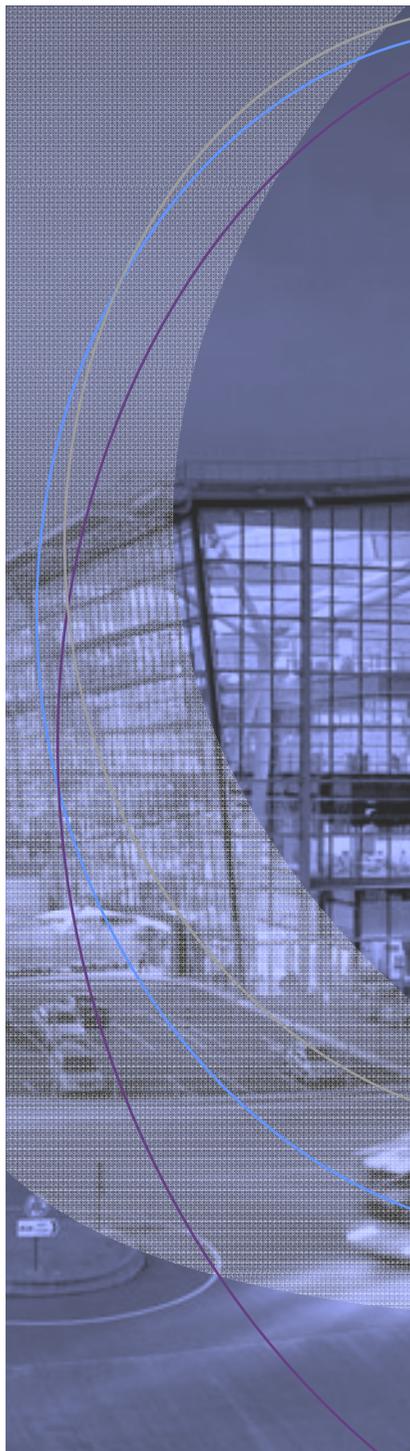
Airport with high level of market power could profitably...
... raise prices
... reduce service quality
... scale back investment
Relative to the level expected in a well-functioning market.

Assessment of airline choices/switching
- the choices available to reduce their use of the airport
- the cost of making such choices
- examples of actual switching

Assessment of passenger choices/switching
- the choice set to reduce their use of the airport
- the cost of making such choices
- examples of actual switching

Assessment of impact of airline and passenger choice on airport
- sensitivity of airport profits to passenger and airline choices ("critical loss")
- consider impact on all cost and revenue streams
- consider indirect effects of airline choices on passenger choices and vice versa

Heathrow



HEATHROW

Arguments indicating...



	Market Power	Competitive Constraints
Market shares	<ul style="list-style-type: none"> UK's largest airport, by any measure, with very substantial share of UK long-haul and transfer 	
Airline switching	<ul style="list-style-type: none"> Airline network effects at LHR: <ul style="list-style-type: none"> Transfer traffic Alliance alignment and code sharing Moving individual services affects value of entire network ...leading to higher switching costs Many airlines have significant costs sunk at the airport Examples of long-haul switching to LHR when permitted/possible 	<ul style="list-style-type: none"> Some inbound carriers might be able to use other near-neighbouring airports to feed their own hubs from London & South East Some inbound carriers might be able to use other hub airports in Europe (or further afield)
Passenger switching	<ul style="list-style-type: none"> Limited airport choices for many direct, long haul passengers Frequency important to some passengers A range of premium services are offered at LHR Stronger local catchment than some other EU hubs 	<ul style="list-style-type: none"> Choices for non-premium short-haul and transfer passengers: <ul style="list-style-type: none"> 86% of short-haul routes are also offered at other LON airports Transfer passengers consider other hub airports as alternatives

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Arguments indicating...



	Market Power	Competitive Constraints
Pricing and behaviour	<ul style="list-style-type: none"> • Persistent, strong demand for slots, despite rising prices, which are higher than many major international airports 	
Capacity constraints	<ul style="list-style-type: none"> • Capacity constrains LHR to be focused on network operations and long-haul, limiting the number of 'marginal' services 	<ul style="list-style-type: none"> • Long-term position potentially threatened by other hubs <ul style="list-style-type: none"> • But could reflect limits on capacity growth, and not represent a constraint on current pricing

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Is current situation likely to be persistent or to change in the short run?



	May persist in short run	May change in short run
Hub and airline network effects	<ul style="list-style-type: none">Airlines appear likely to continue to focus on networks, with continuing trend towards greater consolidation	
Lack of realistic substitutes	<ul style="list-style-type: none">Creating a new hub or moving a hub not impossible (e.g. MUC) but takes a very long time	
Long-haul traffic	<ul style="list-style-type: none">Position in long-haul markets appears strong, with some growth at regional airports, but examples of unsuccessful expansion at other London airports (e.g. MaxJet, EOS)	<ul style="list-style-type: none">But, operators feeding non-UK hubs are growing in importance (Air Asia X, Singapore, Emirates), and some long-haul growth at Gatwick

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Emerging view

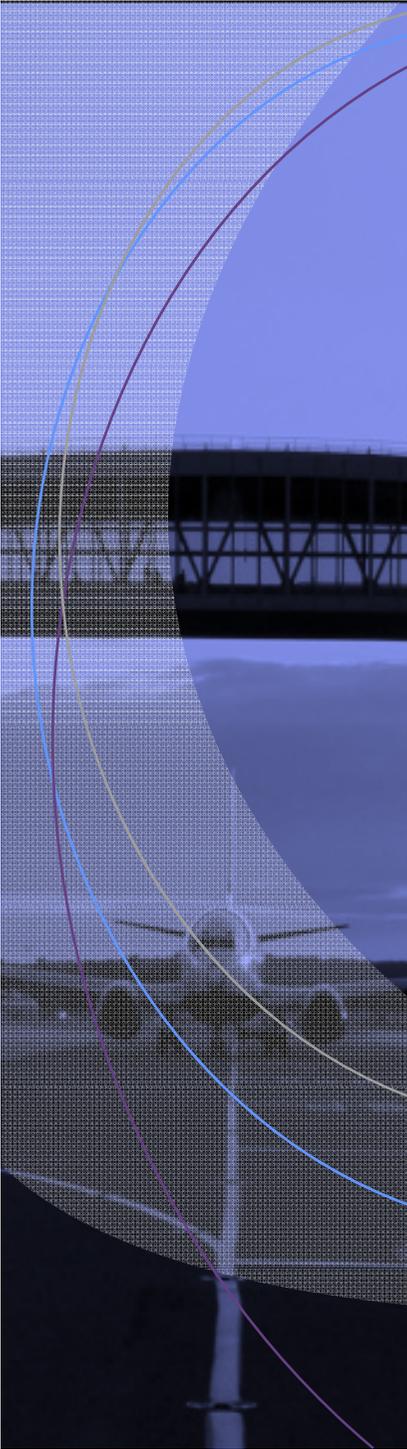


Emerging view:

- Airline network economics and strong local catchment combine to give LHR a strong market position that appears unlikely to change in the short or medium-term
- Airlines and/or passengers might be able to switch away from LHR for some services (e.g. inbound carriers feeding their own hubs abroad), but unlikely to be sufficient to constrain LHR's behaviour

This view relies upon:

- The importance of airline networks at the airport, across a large proportion of the services at the airport, combined with a strong local catchment



Gatwick

GATWICK

Arguments indicating...



	Market Power	Competitive Constraints
Market shares	<ul style="list-style-type: none"> • Serves largest number of outbound holiday makers • Appears to serve a niche long haul market, with focus on holiday makers 	<ul style="list-style-type: none"> • Some airlines might have choices in a wider UK or even EU market
Airline switching	<ul style="list-style-type: none"> • Evidence suggests some airlines serving certain passenger segments face high switching costs (e.g. long-haul) • Switching ability of some airlines might be insufficient to protect carriers with high switching costs (where these serve different passenger segments) • Limited evidence of switching away from LGW <ul style="list-style-type: none"> • LHR capacity constraints limit switching potential from LGW • Previous switching to LHR prompted by unique events (Open-skies) • Lost traffic appears to be replaced by other carriers 	<ul style="list-style-type: none"> • Some airlines face lower switching costs due to less dependence on network effects and potentially larger number of alternatives • Large neighbouring airport (STN) has spare capacity to accommodate potential switching

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Arguments indicating...



	Market Power	Competitive Constraints
Passenger switching	<ul style="list-style-type: none"> • High income catchment in south east • Limited evidence of significant passenger flows from south of London to airports north of London 	<ul style="list-style-type: none"> • Large route overlap (76% of short-haul) with other LON airports • Some evidence of price responsiveness
Capacity constraints	<ul style="list-style-type: none"> • Runway capacity constrained at peak times and in summer 	<ul style="list-style-type: none"> • Some spare capacity off-peak and particularly in winter
Pricing and behaviour	<ul style="list-style-type: none"> • Noticeable change in the way the airport is run, e.g. passenger facing improvements, marketing to airlines, operational improvements, investment plans. Could be the product of a more competitive operator, or more commercial operation by an airport with SMP. • Some concerns expressed by airlines on the airport's conduct, but some airlines recently switched to LGW • Introduction of strong price incentives to attract traffic in off-peak and in winter: <ul style="list-style-type: none"> • Consistent with behaviour of competitive and commercial operator • But also consistent with efficient monopolist behaviour (overall still prices up to the cap while trying to maximise use of assets) • Usage is near capacity, despite pricing at the cap <ul style="list-style-type: none"> • If cap is close to competitive price level – might indicate potential for market power • If cap is significantly below the competitive price level – evidence inconclusive • Evidence for competitive price level being above the current cap: Gatwick/FTI work 	

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Is current situation likely to be persistent or to change in the short run?



	May persist in short run	May change in short run
Competitive constraints from nearby airports	<ul style="list-style-type: none">• Capacity constraints at nearby airports are unlikely to reduce in the short to medium term, and may increase	<ul style="list-style-type: none">• Sale of STN could increase the strength of competitive constraints placed on LGW
Catchment area advantages	<ul style="list-style-type: none">• Are the catchment advantages persistent?<ul style="list-style-type: none">• North/south London surface access hurdles? – could be persistent• Perception that alternatives north of the Thames are less attractive? – might be transitory (depends on STN's future behaviour)	

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Emerging views/focus of further work



Emerging view:

- Evidence on the strength of competitive constraints is currently mixed
- Some credible arguments support the view that there is an appreciable degree of market power, at least over the near-term:
 - Limited impact of potential airline switching on the airport
 - Strong local catchment and lack of evidence of passenger willingness to use other airports
- Evidence of changing behaviour is not conclusive, as it could reflect a more commercially-run airport with SMP or a competitive airport operator

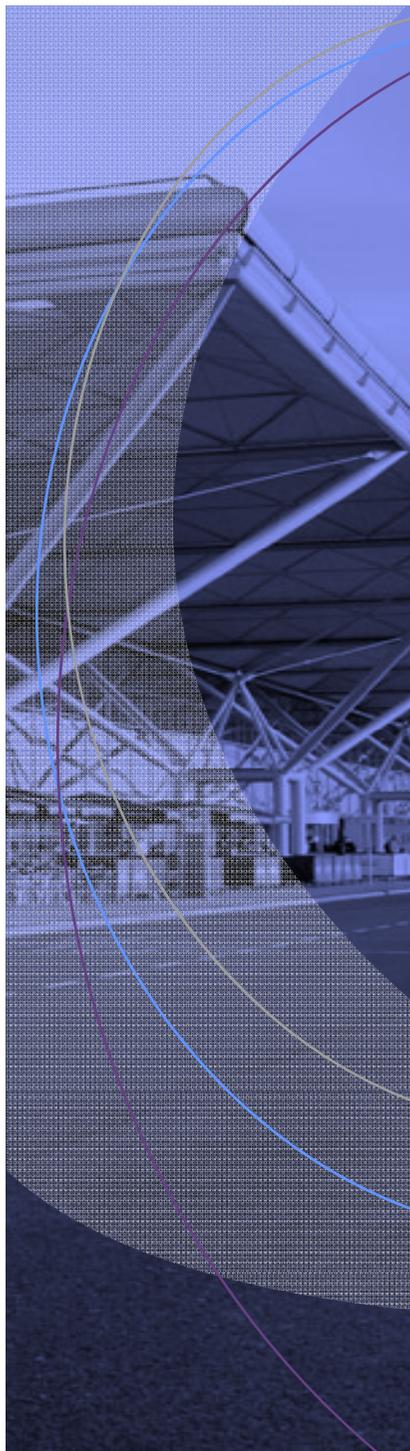
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Emerging views/focus of further work



- **Much depends on the view taken on:**
 - Whether STN is sold and the impact this has on LGW
 - Relationship between the current cap and the competitive price level
 - What is the likely impact on the airport of some airlines being able to switch elsewhere in the UK (e.g. charters) or EU (e.g. LCC)?
- **Evidence has yet to be fully scrutinised by CAA and stakeholders:**
 - easyJet/Frontier work on switching
 - Gatwick/FTI work on competitive price levels
 - Gatwick's arguments on market power

Stansted



STANSTED

Arguments indicating...



	Market Power	Competitive Constraints
Market shares		<ul style="list-style-type: none"> No high market shares in any particular passenger segment
Airline switching	<ul style="list-style-type: none"> Based carriers' ability to switch to neighbouring airports limited by constrained capacity at other airports 	<ul style="list-style-type: none"> Airline business models support switching between airports: lower sunk costs; active negotiation; and multiple bases across UK and Europe Lost several major airlines (Norwegian, Air Berlin, Air Asia X) More near-neighbouring airports with capacity than LGW Evidence of marketing to airlines, and some example(s) of growth offers Increasingly concentrated customer base (esp. Ryanair)
Capacity constraints	<ul style="list-style-type: none"> Very limited spare capacity during a narrow peak period (with limited prospects for additional capacity at this time of day) <ul style="list-style-type: none"> Morning peak capacity relevant for attracting based, low-cost aircraft 	<ul style="list-style-type: none"> Ample spare capacity off-peak, through much of the day

STANSTED

Arguments indicating...



	Market Power	Competitive Constraints
Passenger switching		<ul style="list-style-type: none"> • Near-neighbouring airports with similar offer • Some evidence of price responsiveness
Pricing and behaviour	<p>Common ownership with LHR:</p> <ul style="list-style-type: none"> • Weakens incentive to market the airport • Weakens incentive to attract inbound, point-to-point long-haul 	
	<ul style="list-style-type: none"> • When contracts expired, prices to major airlines rose significantly • Airport now pricing near the cap (implications depend upon view taken on the 'competitive' price level) • The significant reduction in airline use of the airport could either reflect economic trends or price responsiveness • Has been argued that the airport is not offering the types of deals that would be expected from a competitive airport with spare capacity: particularly, that there is a lack of aggressive deals for growth. 	

STANSTED

Is current situation likely to be persistent or to change in the short run?



	May persist in short run	May change in short run
Joint ownership	<ul style="list-style-type: none">• Ownership effects might persist if STN is not sold to a competing owner	<ul style="list-style-type: none">• Ownership may change in the near future<ul style="list-style-type: none">• Impact depends upon the new owner• Unlikely to be in sufficient time to provide compelling evidence on behaviour for the Q6 decision• Might address concerns on incentives to compete for traffic
Recent traffic trends		<ul style="list-style-type: none">• Passenger demand may recover as economy recovers and capacity tightens.

STANSTED

Emerging views/ focus of further work



- **Emerging view**
 - Most evidence supports the view that STN faces stronger competitive constraints than LGW and LHR
- **The view on airport market power depends on:**
 - Whether major airlines can discipline the airport at peak – now and as demand grows
 - Whether the airport's behaviour suggests that it is actively competing to fill its off-peak capacity
 - Whether the current price cap is close to the competitive level
 - (Looking ahead) What impact ownership change might have
- **CAA also needs to consider evidence from easyJet/Frontier on switching costs and airline & passenger responsiveness**

WAY FORWARD



- **Stakeholders invited to:**
 - Submit further evidence by end November
- **The CAA’s Initial Assessment will be published in January and will be consulted upon**
 - Further opportunity to provide evidence and views

15 November	Stakeholder seminar
November	easyJet/Frontier published
November	Gatwick publishes FTI work and own view on market power
30 November	Deadline for submissions to the CAA
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