

## Frontier Presentation: Market Power Assessment of Gatwick and Stansted

Comments by David Starkie

The major reservation I have concerns the use of averages in the Frontier model. With air travel, there is pronounced product price discrimination; flights on different airlines are sold at many different prices to consumers with heterogeneous preferences for service attributes. And even on a single class flight, tickets are sold at prices that vary enormously<sup>1</sup>. The distribution of these fares around the mean value is uncertain. It is probable that a few fares are sold at high prices, mostly to business travellers, and many at low prices, mostly to leisure travellers.

The average used in the Frontier analysis (*Slide 8, column 2*) is taken from the IPS survey and I assume is airport specific. But, it should be noted that this average is around twice easyJet's network-wide average fare, net of ancillary revenues<sup>2</sup>. Also in view of the emphasis now placed by easyjet on the business traveller it is likely that even the latter average is a mix of a *few* sales to business travellers at relatively high prices (allowing flexibility) and *many* sales (in advance) to leisure passengers at low prices<sup>3</sup>. Consequently, the incidence of the assumed increase in airport charges used in the Frontier analysis is likely to much greater than is suggested by the increase in the price of the average ticket.

I also note that the presentation graphic referred to route level elasticities estimated by IATA of -1.2 to -1.5. I am not sure which market segment these take into account (and low cost airlines are not usually members of IATA) but I was lead to believe on the basis of past conversations with the LCC industry representatives, that their business-case fare analysis was done on the basis of

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<sup>1</sup> Alves and Barbot show that the low-cost carriers' (LCCs) pricing system is characterised by a single class of booking that starts with a minimum fare and then monotonically increases its value over time. This is a form of price discrimination although markets are not physically or temporally separate. Using game theory techniques, this paper shows that this Lo-Hi (low first and later high) strategy is optimal under certain ranges of fare. The paper also finds that the existence of different probabilities of consuming the good and of different willingness to pay makes it possible to separate markets in time and to profitably price discriminate. See Price Discrimination Strategies of Low-cost [Journal of Transport Economics and Policy \(JTEP\)](#), Volume 43, Number 3, September 2009 , pp. 345-363(19)

<sup>2</sup> <http://corporate.easyjet.com/investors/presentations-webcasts/~media/Files/E/Easyjet-Plc-V2/pdf/investors/results-centre/2011/2011-full-year-results-analyst-presentation-pdf.pdf>

<sup>3</sup> For example, at noon on Sunday 11 December next day fares, London-Nice on easyJet's website were Stansted: £73.99 standard, £173.99 flexible and Gatwick: £78.99-103.99 standard, £193.99 flexible.

assumed elasticities of -2.0 to -3.0: LCC traffic, of course, dominates at Stansted and is a major component at Gatwick.

With respect to the impact of switching on airline costs (*Slide 16*), it was mentioned during the presentation that crew location costs were the least important component because of staff turnover; marketing costs and route maturity costs were more important. However, I would note that many airports offer assistance with marketing new routes and that this assistance can be considerable. But the proof of the (Christmas) pudding is in the eating. I understand that recent analysis by Copenhagen Economics of OAG data for 2007-2011 indicates that 50 to 60 per cent of Ryanair's routes in any given year are new routes not operated the previous year and that Ryanair has approximately 500 route openings per year and approximately 300 closures.