

DRAFT

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

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The purpose of this note is to draw attention to a generally neglected aspect when assessing market power in the supply of airport services. It develops a point made *en passant* in a paper written by the current author and George Yarrow for the UK CAA in 2010¹. That paper stressed that, although it was the standard practice in competition assessments to define substitution possibilities from *within* a defined market, sources of constraint on market power also arose from substitutable products defined to lie *outside* the relevant market and that it was the cumulative effect of all the substitution possibilities that determined the own-price elasticity of demand for a product or service.

In the case of airport passenger services, market assessments focus on various product market distinctions such as long-haul vis short-haul flights, premium services vis low cost services, network services etc. The geographic market analysis focuses upon airport catchment areas and the competitive constraints of other proximate airports. But Starkie/Yarrow drew attention to constraints lying outside airport markets defined in this way. The example given was the substitution possibilities available to *in-bound* tourists in the form of alternative holiday destinations lying outside the relevant market. Specific mention was made of a tourist flying into Blackpool, a UK holiday resort, but resident in Dublin, Ireland who could substitute a flight package to Alicante, Spain; Blackpool Airport would not normally be thought of as competing for passengers with Alicante Airport², but competing within a geographic market that might include the UK airports of Manchester, Liverpool or Leeds.

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

¹ Market Definition in the Airports Sector at <http://www.caa.co.uk/docs/5/ergdocs/MarketDefAirports.pdf>

² But airports in different parts of Europe might be thought of competing to attract downstream airlines to establish routes and operating bases.

segment the market and price discriminate between passenger types³. This limits the possibilities for isolating what is considered to be the relevant market from the competitive effects of substitutable products that lie outside the relevant market.

At the end of the day it is an empirical issue. Unfortunately, the required statistics are not always to hand. It is reasonably common for airport passenger data to distinguish between business and leisure traffic, but not between traffic originating in the airport's geographic catchment and in-bound traffic. In addition, not all in-bound leisure traffic has easily substitutable alternative destinations. In particular, leisure traffic classified as visiting friends and relatives (VFR) has much more limited substitution possibilities but these finer category distinctions are not always apparent in data. What is needed is data on passengers who are in-bound tourists *per se* because it is this sub-category of leisure traffic that has most substitution opportunities: the individual, couple or family, that *ex-ante* is able to choose from a multitude of different holiday destinations, some domestic and some foreign.

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

**FOREIGN RESIDENT HOLIDAY-RELATED PASSENGERS
USING THREE LONDON AIRPORTS 2010**

	Foreign Resident Passengers (000)	Percentage of Total Passengers
STANSTED	2632	14.25
GATWICK	2546	8.21
HEATHROW	11,556	17.60

³ See Starkie D. *Aviation Markets: Studies in Competition and Regulatory Reform*, Ashgate 2008, PP 143-144.

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

In addition to foreign-resident tourists flying into London's airports there are UK residents visiting London as tourists who make use of domestic air services from Northern Ireland, Scotland and the North of England. Unfortunately, it is not possible to isolate these numbers in the published statistics, but it is expected that the numbers will be relatively small, adding perhaps one or two percent to the in-bound tourist totals shown in the Table.

Thus, in any analysis of the market power of airports there is an element of the market where an airport's power is constrained by substitutable products defined to lie *outside* the relevant market. In the case of London's airports this constraint comes from numerous holiday destinations in Europe and elsewhere so that there are many airports outside the relevant market against which the London airports compete: the situation is analogous to hub airports competing for transfer traffic. For the three regulated London airports, the, *ex-post*, component of total usage that has been subjected to this form of competition is of relative modest size, accounting for about 10 and 20 percent of the total passenger market. But the significance of the constraint is greater than the figures suggest because of the limited ability of airports to adopt pricing strategies that can segment and isolate this competitive margin.