

Future of service quality regulation for Heathrow Airport Limited: Consultation on the design principles for a more outcome-based regime (CAP 1476) Heathrow's Response

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Introduction

Heathrow welcomes the opportunity to respond to the CAA's consultation on the design principles for a more outcomes based regime. Heathrow sees a need for change when it comes to service quality regulation. We were of the same opinion in the last price control review, where we proposed to move towards a Service Level Agreement (SLA) approach between airlines and Heathrow. Unfortunately, the regulatory response was for more prescriptive regulation with added complexity and reduced symmetry. We provide our full response to the consultation questions below. However, we believe the following are the key points in favour of a case for change in service quality regulation.

The Service Quality, Rebate and Bonus (SQRB) scheme:

- does not mimic the nature, incentives or processes of a mature customer / supplier relationship in a competitive business-to-business environment
- is based upon the assumption that service is fundamentally very poor at Heathrow and requires draconian regulatory intervention to coerce the airport into just delivering a baseline service
- was created almost 15 years ago, with limited change since, so it is out of date in a number of elements and often overly complicated or inflexible
- at times drives counterproductive incentives, does not balance risk and reward in its incentives in a way seen in other regulated industries, and can constrain how Heathrow deploys its resources in a way that does not contribute to improving passenger experience.

A shift to an outcomes focus is supported by the reality that Heathrow now delivers a good and improving passenger service. Our service generally far exceeds the levels envisioned in the original SQRB, for example:

- in the last three months of 2016 we achieved our highest ever Airport Service Quality (ASQ) score of 4.19. 84% of passengers rate their Heathrow experience in the ASQ as either excellent or very good. Heathrow is consistently rated the highest for passenger satisfaction of major European hubs and ahead of Gatwick, Stansted and London City. Likewise, in the global SkyTrax survey, 16 million travellers voted Heathrow the best airport in Western Europe.
- Heathrow has been transformed over the past ten years with investment of £11bn in new infrastructure so that over two thirds of passenger travel through new facilities.
- we have reflected our increased service ambition in our vision to *"give passengers the best airport service in the world"*. Passenger service is central to the company-wide bonus scheme and included in every employee evaluation.

Furthermore, our drive to improve service comes from underlying commercial reasons. Our service proposition is one of our key competitive advantages relative to our European and UK competitors. A comprehensive, consistent and tailored service proposition supports our commercial revenues. Better service is also a common purpose that motivates our teams. It is only by delivering consistent quality service to passengers that Heathrow will successfully deliver expansion. In this context the time is ripe for a more flexible, modern service quality regime that is focused on a baseline level of outcomes for the end passenger. There needs to be less focus on prescribing how the airport delivers and more on the end result.

Heathrow therefore welcomes the CAA's consumer focused approach. We agree that there is a clear case for us to focus more on the right outcomes. Doing so will generate the right incentives for efficient and effective delivery. We have some sympathy for the desire to evolve rather than start from a blank sheet of paper. However, we are concerned at the sense of inertia around the current scheme and the tendency toward a regulatory ratchet. That ratchet adds complexity, escalating regulatory targets heedless of cost, and ever greater intervention in metrics or process. We would urge the CAA and airlines to be bold. Let's start with an honest assessment of what, if any, 'problem' for passengers it is that needs to be addressed and a flexible, commercial view of how to deliver for the end customer.

Responses to the CAA's questions

Do you agree with the case for change in service quality regulation at Heathrow airport, as outlined in Chapter 3?

We agree with that there is a clear and strong case for change in service quality regulation based on the following reasons:

1. The SQRB is largely unchanged since 2003. We believe that any future service quality regime should reflect the current high levels of passenger satisfaction at Heathrow and ensure alignment of the scheme to what consumers value.
2. The SQRB is over focused on the detail of how Heathrow delivers service and insufficiently weighted toward the ultimate result for passengers. As in other sectors, an outcomes based approach should increase focus on whether customers are satisfied with the end result. This principle should be central to thinking about the scheme.
3. The current scheme is designed such that 'one size fits all' and doesn't account for different passenger needs. We consider that this can constrain Heathrow's ability to provide excellent customer service to all passenger segments.
4. It is far from clear whether the current scheme is complete, whether the performance metrics are out of date or not¹ or how the CAA can satisfy itself that the current scheme meets its statutory duties.
5. Another drawback of the SQRB is that it does not incentivise all parties to join efforts on the needs of the "end to end" consumer experience.
6. In conclusion, none of this means Heathrow should not be held to account with clear targets – on the contrary these should be challenging and meaningful in terms of maintaining and improving actual passenger experience. But we urge the CAA and airlines to be bold in terms of revising the scheme.

Have we accurately reflected stakeholder views, as outlined in Chapter 4? Do you have any comments on our proposals regarding the level of stakeholder engagement we require of HAL in developing an outcomes framework?

In the main the CAA have accurately reflected Heathrow's views. However, we have the following further comments regarding the level of stakeholder engagement in developing an outcomes framework:

7. This is the beginning of an important chapter for H7 ahead of the publication of Heathrow's Initial Business Plan. Crucial to which will be the engagement of the Consumer Challenge Board (CCB) and airline community which will provide valuable insight into designing the outcomes, measures and targets and ensuring they are aligned with what consumer's value and are willing to pay for.
8. Engagement must be based on comprehensive insight on passengers, not anecdote or theory. It also requires senior engagement from airline commercial and operational executives. This is

¹ The current service quality dimensions are not necessarily based on what consumer's value and are willing to pay

the way that successful businesses improve their customer service and engage effectively with their customers. The CAA has a role to play in ensuring quality input.

9. We agree that financial incentives should focus on Heathrow's performance. We do not see that this precludes incentives that will help focus all stakeholders on the whole customer experience.

Do you have any comments on the proposed principles?

10. *Principle 2: The Structure of OBR should include outcomes, measures, targets and incentives* - should factor in where consumers would prefer to trade a reduction in performance in one area in order to improve performance in another area.
11. *Principle 3: Airlines and CCB play a key role in the development of OBR* - the CCB and airline community will provide invaluable insights into what consumers value and therefore their engagement in the consumer research that will underpin the OBR framework will be important. The input will be most useful if at a senior level, data driven and provided early.
12. *Principle 4: OBR should build upon the SQRB: whilst we agree that OBR* - should build upon the success of the SQRB in terms of driving a consumer approach. We do not agree that OBR should build in more measures if it leads to an overall package of measures, which from a governance, recording and reporting perspective, is more complex, less cost effective and more onerous to manage than what exists today.

Do you consider there are further principles that should be included, or principles that should be removed?

13. A further design principle that should be included is that OBR should reduce complexity, and the need for regulatory intervention. Another design principle should be that OBR should not include measures that prescribe and therefore limit Heathrow's ability to offer a quality service to passengers.

Do you have any comments in terms of the proposed structure of the OBR framework, specifically?

We have the following comments on the individual elements proposed within the overall structure:

14. Outcomes – need to be simple and easy to understand and should represent what consumers value from sophisticated consumer research not simply assertion.
15. Measures – there needs to be a balance between customer perception and output based measures. Measures should focus all stakeholders to deliver against what consumers value. Measures and targets should align with the investments and service improvements in Heathrow's business plan.
16. Targets – knife edge targets do not necessarily incentivise the service proposition and investment decisions that consumers value. The framework should consider other approaches.
17. Incentives – we agree that these could be financial or reputational but that financial targets applied to Heathrow need to be within Heathrow's control. The framework needs to be more balanced in terms of risk and reward and align to what consumers value. It would also make

sense for incentives to be structured to direct resources to fixing any issues that arise in service levels – as happens in many commercial contracts. There should be flexibility for airlines and airport to direct resources and adjust operations and performance standards on a regular basis.

Do you agree that consumers would benefit from increased transparency on the performance of other parties providing services who play a major role in their experience at the airport?

18. We fully agree that consumers would benefit from increased transparency on the performance of other parties. This is a well-established economic principle.
19. We also disagree with the airline view that providing greater transparency on the overall performance that consumers experience will distort competition. On the contrary, it will reflect what would happen in a competitive environment and will therefore benefit consumers.