

BAA AIRPORTS MARKET INVESTIGATION

Flybe Limited: summary of hearing, 11 July 2007

Background

1. Flybe told us that it operated from 23 UK airports, including five of the seven BAA airports. It did not fly from Heathrow or Stansted. It was the largest operator at Southampton Airport, carrying about 90 per cent of passengers using the airport, and the fourth largest operator at Edinburgh and Glasgow airports. Its business model concentrated largely on domestic flights, which accounted for most of its business, flights to major European cities and flights to regional airports in France. It was essentially a low-cost airline that provided a range of additional services for passengers to buy, giving it a high per passenger rate of ancillary revenues. About 50 per cent of its passengers were travelling for business reasons.

Relations with BAA

2. Flybe said that its operations at Southampton had grown from 100,000 passengers in 2002 to 1.9 million passengers in the year to 31 March 2007. This growth had been achieved without the support of BAA; [redacted]. Flybe said that in the airline industry the only way of putting pressure on an airport operator was to threaten to move to another airport, but at Southampton this had little effect because the only other options were Gatwick and Heathrow.
3. BAA had demonstrated a startling lack of ambition for Southampton in its discussions with Flybe and also in the run-up to the 2003 White Paper, when the DfT suggested that the airport could reach the capacity of 7 million passengers but BAA thought that 2 to 2.5 million passengers was a more appropriate target. BAA had not endorsed Flybe's growth plans at Southampton.
4. It would be wrong to characterize BAA as a monoculture lacking ambition throughout the organization. Part of the problem had been organizational change and instability over the previous three or four years. The longest serving airport managing director was the one at Southampton and he had been in post only 14 months (at the time of the hearing). Flybe had no complaints about Southampton as regards day-to-day operational efficiency, but BAA had been slow to develop a retail base that might have taken pressure off the aeronautical revenue. The airport had gone through a difficult period getting to grips with additional security requirements but the problems had not been as severe as at Gatwick and Heathrow, and had been resolved. BAA had doubled the central search capability and capacity at Southampton. As for the other BAA airports where Flybe operated, all of them except Glasgow came off badly in comparison with other mature, established airports of similar size, such as Birmingham and Manchester. Glasgow provided a more positive experience as its management had an external-facing view and an understanding of customer culture. Flybe had noticed little change in BAA's objectives since the acquisition by Ferrovial.

Competition between airports

5. Where there was a substantial overlap in the hour to an hour-and-a-half's drive time from two or more airports, there was scope for competition between the airports. One example of this was Belfast, where the introduction of competition between Belfast City and Belfast International airports had facilitated further competition between airlines, resulting in some of the fastest growth and most dramatic lowering of prices that had been seen over the past ten years. Competition between airports was in most cases on price rather than service. If an airport had aspirations to be high volume and high growth, it would approach airlines to move into routes which were not served or underserved and would negotiate a price at which the deal could be done. An airport that could not deliver service over a long period of time would lose business, but in Flybe's experience most of the UK airports it used could deliver a service that was acceptable to customers most of the time.
6. Other examples of competition between regional airports were Exeter and Bristol, Manchester and Liverpool, Leeds Bradford and Doncaster and East Midlands and Doncaster. Flybe said that regional airports regularly offered incentives to airlines to start flying new routes, depending on the structure of the airport's business and how important the airline was to it. Manchester Airport had some of the best incentives for start-ups and applied them universally; it had an aggressive approach to growth and carried out infrastructure projects to deal with it. In general, the additional volume that an airline could bring was the prime factor in influencing an airport to offer an incentive, although the opening of new routes could also be important, particularly where a route was key to a local economy.
7. Bristol Airport had felt the competition from Exeter, especially after Flybe had started flying from Exeter. Its response had been to bring in Ryanair, which should give them large volumes of passengers. This in turn would put pressure on easyJet, bmi and Flybe and the regional airports they used.

Southampton Airport

8. Southampton was a restricted field airport, which meant that larger aircraft could not take off with full payloads. It was a modern airport with reasonably good facilities and a direct rail link to London Waterloo. The rail line was only 99 steps from the check-in. Flybe said that there was enough land in terms of airfield operations but if the airport wanted to expand it would have to either put more capacity on the other side of the airfield or take over a large multi-storey car park, owned by a non-BAA operator, outside the front door. Neither option had seemed attractive to BAA so far. Air France was the second largest airline flying from Southampton and there were also several small carriers.
9. Flybe said that it had chosen Southampton as its base because it saw it as a major south-east and south coast marketplace opportunity and a strong contender to be an alternative London airport. Given the train service from Waterloo, the journey time from south London was not much greater than to Gatwick. The restricted field was also helpful to Flybe initially as it did not face direct competition from larger aircraft while it was developing its business model.
10. If, hypothetically, Southampton was owned by an operator other than BAA, Flybe would expect to have discussions with that operator about its ambitions and projections for passenger growth and to reach agreement with the operator on the development and capital expenditure needed to achieve the growth. This is what had happened at every other airport outside the BAA portfolio. Flybe had envisaged a growth in annual passengers at Southampton to 3.5 million within two years and

thought that the expenditure on additional stands that would be required to accommodate the additional traffic was between £4 million and £7 million. Expansion of the terminal could cost a further £2 million to £4 million. However, the operator would need to decide what to do about the car park at the front: the site could be used for additional terminal capacity and parking be moved to across the railway line. The runway was just short of 1,400 metres long and could be extended in one direction, although this was not an issue for Flybe. A new operator wanting to attract other airlines to Southampton would use introductory offers, which might be available to airlines that started flying new routes, or might be linked to the amount of additional volume the airline could deliver. It would then be for the airlines to attract the passengers. Flybe thought that any of the regional operators could relocate to Southampton as an alternative to Gatwick.

11. Flybe thought that BAA had not developed Southampton Airport, despite the capacity constraints at its London airports, because it did not understand how to develop a regional airport. There were also considerable overlaps in the catchments of Heathrow, Gatwick and Southampton; this may have deterred it from investing in Southampton for fear that the result would be a fall in passengers at the two larger airports. [✂]
12. Flybe said that it had difficulty negotiating charges at Southampton because of BAA's ownership of the three London airports as well Southampton. Apart from some small opportunities for growth at Gatwick it had nowhere else to go. Bournemouth did not compete with Southampton because it was too far from London and was outside the South-East.

The Scottish airports

13. Flybe told us that when it was looking for fairly substantial growth in Scotland it had decided to fly from Edinburgh, which had a higher proportion of business passengers than Glasgow and so was less risky, given Flybe's business model. In talks with the then BAA account manager for Scotland in 2003, it was explicitly stated that if Flybe would also operate to the same destinations from Glasgow, where BAA wanted to have more traffic, then it would be charged at a lower rate at both airports. If it wanted only the Edinburgh option then it would be charged a higher rate. The current management of BAA had, however, stated that such arrangements were no longer offered and there was totally separate pricing for each airport.
14. Flybe had found that it could achieve volume on its routes from Glasgow but that the yield was lower than on the Edinburgh routes because Edinburgh was a richer marketplace. It did, however, see the two airports as operating in the same market, given their relative proximity and the fact that the same media titles covered both cities. It was possible to use prices to move traffic from one to another. Prestwick exerted some competitive constraints on both airports, primarily for leisure flights and much less so for business travel. Flybe did not believe that Newcastle Airport competed with Edinburgh or Glasgow, except perhaps very marginally in the Borders region.
15. Aberdeen Airport operated in a completely separate market from Edinburgh and Glasgow. It experienced a weak competitive constraint from Inverness Airport. Aberdeen had suffered from a lack of strategic focus in BAA, as had Glasgow until 2004, whereas Edinburgh had held its own in terms of investment and infrastructure.

BAA London airports

16. As a result of the Open Skies agreement Heathrow would be increasingly transformed into an intercontinental hub and domestic and European short-haul flight would increasingly be squeezed out. It was unclear whether different ownership would make any difference to Heathrow, although it would to Gatwick and Stansted. Gatwick's role was going to change fundamentally as American airlines decamped to Heathrow and there would be scope for competition between it and Stansted and Southampton. Separate ownership would be the best way of creating competition. Airlines would be prepared to switch between airports for lower charges, even though there were costs involved, as evidenced by major movements of easyJet and Ryanair capacity between Luton and Stansted. It was, however, more difficult for a hub and spoke operator to move. The cost and risk of moving was greatly increased if the airline had aircraft based at the airport.
17. Flybe believed that separate ownership would lead to improvements in quality of service and use of capacity. For example a separate owner of Southampton would seek to maximize use of its capacity without worrying about the effects on Gatwick and Stansted. Its belief that standards of service would improve was based on the experience of competition between Belfast City and Belfast International airports which had led to investment and innovation in retail offerings, check-in facilities etc. It did not think that it would be difficult to find capital investment for each of the London airports under separate ownership, and commented that capital projects undertaken by BAA tended to take longer and be more expensive than those at other airports.
18. While competition between airport terminals might be a possibility, Flybe thought that competition between airports would be a better solution. It commented that it would be difficult to match terminal capacity and runway capacity in such a way as to produce competition between terminals.
19. In Flybe's view, regulation of airports had not worked very well. It would prefer to see airports competing among themselves, and it assumed that this would lead to price rises at Heathrow and lower prices at Gatwick, Stansted and Southampton. On the issue of gold-plating, it commented that BAA's engineering projects tended not to be innovative and were driven by standards that were set for Heathrow and then disseminated around the group, whether or not they were the best solution for a particular airport.
20. Flybe thought that there was more than enough capability within existing planning constraints and agreements for Southampton to expand to 5 million to 6 million passengers. Some spare capacity might become available at Gatwick as a result of Open Skies, depending on how many short-haul flights displaced from Heathrow were relocated there.

The Q5 review

21. Flybe was unhappy about pricing at Gatwick, where airlines based in the South Terminal were charged the same as those in the much superior North Terminal but got very little in return. Flybe thought BAA was hiding behind the regulatory regime in not introducing differential charging. It told us that at Glasgow Airport BAA gave a 25 per cent discount to airlines using a low cost pier, although it was possible that this practice would be ended.