COMPETITION COMMISSION

Summary of transcript of hearing with Manchester Airport Group

17 June 2008

Market position

1. Manchester airport had not yet been de-designated. The Statutory Instrument had not yet been laid before Parliament, and this would not happen until March 2009. Airlines had started to negotiate with Manchester Airport Group (MAG) in the expectation that it might move from a tariff-based pricing regime to a contract-based regime, but MAG was still working on its pricing strategy for the next year. East Midlands, Bournemouth and Humberside related differently to their customers on pricing.

2. MAG was happy that easyJet was operating from Manchester. Low-cost carriers (LCCs) would be likely to contribute significantly to Manchester's growth over the next few years. The court case with Liverpool Airport had apparently been settled, though MAG did not know what the terms of that settlement were. MAG was reviewing its activities at Humberside, and might want to sell the airport, because it had not attracted LCCs. Humberside might absorb a disproportionate amount of development effort over the next few years.

3. Airlines were always looking to maximize their opportunities at any airport, and airport charges were part of that, although likely to be a small part of their operating costs. At the moment, Manchester had a tariff, which everybody paid, with discounts and incentives, some depending on the time of the flight and some for opening new routes. Airlines might expect more pricing flexibility now that Manchester was no longer regulated. Manchester did not have long-term deals.

4. East Midlands had always had to work harder than Manchester, as it was not the natural choice for airlines in the Midlands. Pricing was a way to lure traffic from Birmingham. Manchester's tariff structure had evolved. Prices had declined overall but the structure had evolved as well, with new incentives or discounts available to all. Ryanair had recently increased its business at Manchester because Manchester's tariff structure had evolved so that it fitted Ryanair's business model. Airlines might switch aircraft to take advantage of time-limited incentives.

5. Manchester was a favourable location for an airline. It had a big catchment area with an established market. However, it faced competition from Liverpool. LCCs, where the growth had been achieved over the last decade, were committed to low costs across the board. Thomsonfly had developed a different model where it operated as an LCC, but still ran its charter business.

6. The tariff structure, in addition to being designed to attract particular kinds of carriers, was also meant to take advantage of the best use of runway assets at Manchester. Manchester had high demand for the use of its runways at peak times and wanted to fill its off-peak slots, though these would be likely to be the flights withdrawn first when an airline needed to consolidate. The pricing structure was designed not only to attract new routes and new services, but also to retain existing business. For instance, Manchester had a large, though declining, charter business and wanted to retain it.

7. Manchester had an aviation development team led by an aviation development director who talked to airlines and attended conferences. East Midlands had a

smaller marketing team and a higher proportion of the regional airport's managing director's time was being spent on stakeholder management. The airport did not really market itself, though the products within the airport were marketed.

8. With IT and charter airlines there tended to be a maximum of a two- to three-year timescale for a new route. A scheduled route might need to mature a year earlier. There would be more commitment from the schedule operator to that route because on the IT and charter side products could change within brochures relatively easily. Manchester had a combination of daily routes and routes with services three or four days a week. The latter would most likely be experimental routes. Routes were now appearing which would have seemed incredible ten years ago. French regional routes would work much better in the North than in the South. These routes could switch relatively rapidly from one regional airport to the next. The period the LCCs were giving a new route to pay for itself had declined. The attitude towards switching would depend on what was being switched. A 'W' pattern route would be much easier to switch than part of a based aircraft's committed programme.

9. East Midlands overlapped almost completely with Birmingham in charter destinations, and the majority of scheduled destinations. Ryanair had switched some Ryanair 'W' patterns from Birmingham to East Midlands which then developed into Ryanair basing aircraft at East Midlands. A shrinking market was a different dynamic from a growing market. bmibaby had switched based aircraft from East Midlands to Birmingham. Birmingham had traditionally been East Midlands' main competitor but, recently, competition had developed from Coventry and Doncaster. Doncaster was more of a competitor to East Midlands than Luton or Stansted. East Midlands had always been strong in the charter business, which was important in the conurbations of the North. East Midlands had always been the favoured airport for South Yorkshire, and therefore was suffering from competition from airports in South Yorkshire. The south of the catchment area was also less important because people were generally flying south and were therefore reluctant to travel north in order to fly. Luton and Stansted had access to the London market, which meant that airlines would be more likely to want to develop there. The underlying strength of the London market made the dynamics completely different. With spare capacity at Stansted there would be greater growth there which would mean less opportunity for East Midlands to take business.

10. Turnaround time was important for the low-cost airlines. They needed good performance on security queues and check-in desks and on the arrangement of aircraft on the ramp. In a competitive market, the airlines were expecting low prices as a given. Manchester had begun its consultation arrangements with its customers under regulatory pressure, but was going to continue them when it was de-designated.

11. Around 90 to 95 per cent of airlines based at East Midlands benefited from discounts. Scheduled operators might offer a guaranteed frequency. Tour operators might have discounts on existing as well as new business as MAG was fighting to maintain the product range. For charter operators there might be a discount linked to throughput, while LCC discounts might be linked to frequency. These terms were usually contractual. MAG wanted aircraft to be based, but it would be necessary to define a based aircraft. MAG would not want a based aircraft to use all facilities and then disappear during the day.

Cargo

12. Freight was important at East Midlands, comprising 15 to 20 per cent of turnover. There were four integrators, DHL, TNT, UPS and the Royal Mail. DHL was the most

important, with its own cargo hub at East Midlands. At the moment there was fairly steady growth. Traditionally East Midlands committed areas of land to the use of the freight integrators. Once a building was put up, more business would follow. The integrators generally financed the buildings, though the airport had constructed a freight shed ten years previously.

13. The contract terms would usually detail the ground rent of an area of land. There was a price mechanism which encouraged freight to grow during the day but most integrators flew at night. Pricing was important to the integrators but stability was more so. An advantage was that the M1 ran past the airport. East Midlands was within two hours' trucking distance of most of England apart from the South-West. London was within that distance, which was important because a lot of the East Midlands business was air to air.

14. FedEx operated from Manchester, but its biggest British presence was at Stansted. The Chancellor's recent proposal to replace passenger duty with aviation duty, which would affect flights, might make operation from UK airports potentially less attractive than it was. Some operators at Manchester and East Midlands might move their operations. East Midlands had sufficient capacity for its passenger and freight businesses. Stansted and East Midlands both had night time operations, causing some competition. The integrators would mention price. East Midlands had some advantages but it could not ignore the pricing aspects.

Customer relationships

15. MAG tried to understand what its customers required from it. For instance, it had tried to assist with the construction of Ryanair's flight simulator at East Midlands. When Ryanair had developed a base, it needed check-in desks to accommodate it. MAG built them at East Midlands in a building with canvas costing around £700,000, without air bridges and with a limited life. It was used by both easyJet and Ryanair. Manchester had an identical approach. It had shelved a plan for a high-specification new extension to Terminal 2 because it could not be funded by customers. Instead, a pier would be developed in Terminal 3 with low-cost facilities for use by LCCs. MAG now planned to spend £0.5 billion developing capacity for 5–6 million passengers annually. MAG could not build an extravagant terminal even when its prices were regulated because its customers would not fund the facilities. Being regulated did not mean that Manchester had market power.

16. The CAA's Constructive Engagement had given MAG an impetus to build relationships with airlines in a constructive way. MAG had found it very effective and positive. easyJet were now engaged in the process. As to investment at Stansted, MAG had not looked at SG2 in any great detail. Nor could it guess what kind of facilities could be constructed for £2.3 billion. On future-proofing, Manchester had three terminals which could be built differently to some extent, to suit the different business models of customers which used those terminals. Terminal 1 had a stand for handling A380s while Terminal 3 had an apron designed for faster turnarounds. Terminal 2 had a marble hall for Emirates and Virgin. Transfer was not a big element of Manchester's business. The handling agents transferred between terminals using little vans.

Traffic forecasts

17. East Midlands had cut its forecast growth by 10 or 20 per cent given the high price of oil. It would aim to grow by 6 to 7 per cent a year over five years. In September the previous year Manchester had anticipated growing by 4.1 per cent a year on the

basis of both top-down and bottom-up forecasts. A new forecast, however, might be between 3 and 4 per cent. Growth rates tended to be fairly steady over time. Manchester had had a growing market, but more competition. Charter had always been Manchester's core strength, but as this was declining, the forecast had been reduced.

18. At East Midlands, traffic largely depended on three low-cost airlines, Ryanair, easyJet and Thomsonfly. Charter airlines would not sign off a forecast with 5 to 6 per cent growth. However, airlines would not reject the forecasts. The only passenger forecasts signed off by the airlines to any extent were in September the previous year. Some of the capital expenditure was being postponed as the forecast traffic growth had not been achieved. The airlines themselves were very reluctant to share individual forecasts because they regarded these as commercially confidential. In addition it was not clear how robust their long-term forecasts were.

Operating expenditure

19. MAG could not comment on its own efficiency relative to Stansted. East Midlands had contracted-out security to G4S. East Midlands had an SLA with its security outsource firm. It had been contracted out for more than 13 years. It had been re-tendered on three occasions. There was a regular daily routine to monitor security queue length, by hand and eye. In the last tender process, four tenders had been received, all of which were credible. There were also SLAs with the handling agents, though these were agents of the airlines. There was a licensing system for handlers, and the ultimate sanction was to remove the licence if that standard was not met. The ground handling system was covered by the EU Ground Handling Directive of 1996 and 1997. Airports were only allowed to insist upon basic minimum standards, which tied their hands. However, the airlines would want the airport to help in keeping up the standards.

20. At Manchester, charges were structured on a tariff basis so that everybody received the same deal with the same discounts and incentives available. There had not been a contractual service standard relationship with the airlines though this might evolve in the near future. East Midlands operated its own air traffic control services.

21. Manchester had taken the responsibility for handling passengers of reduced mobility several months early in consultation with its customers. The cost would have increased slightly from the amount agreed per passenger, because volumes were below what was projected, and there were considerable fixed costs for providing the service. It cost around 27–30p per passenger.

22. Security standards were for 95 per cent of passengers to be through the system within 8 minutes at the current threat levels. If the level was critical, the arrangement would be suspended. Manchester was hitting those targets now. It had just opened a new security facility which gave 14 lanes of security screening. Manchester had also just trialled a Bluetooth security system.

23. MAG did not consider it reasonable that passengers who were paying less for their tickets should have a less good service standard; and it had not had any discussion about differential charging for different service standards. At Manchester, most security was not outsourced, though the running of the x-ray machines and the allocation of the gauge bags was outsourced. Security had been benchmarked at Manchester, but it was thought that the savings would not be worth the pain.

Other revenues

24. At Manchester, 56 per cent of revenues were commercial; for retail only this amounted to £2.75 per passenger. At Manchester, £35 million had been invested in security and retail services over the current year, so yields needed to increase. The expansion of the EU had hit both East Midlands' and Manchester's retail yields. Car parking was an important area, and East Midlands might be looking to introduce a more varied product. East Midlands received around £1.90 per passenger from its retail excluding car parking. For both, it was around £3.70–3.80 per passenger.

25. Non-aeronautical charges were provided effectively at break-even prices, making up around 4 per cent of revenue. The cost and transparency had been an issue with third-party handlers.

Other questions

26. It was difficult to say how MAG would run Stansted differently if it owned it. It might try to be more customer-focused, certainly when designing the infrastructure.