AIRLINE Deregulation

WHAT WE CAN LEARN FROM AMERICA
CAN THE HIGH-FIERS STAY AIRBORNE?

By RICHARD GREEN

It’s not all blue-sky for players in Australia’s newly deregulated airline industry. The experience of the United States suggests that difficult.

The termination of Australia’s “two-airline policy” on November 1 has dramatically changed the restrictions applying to the rights to fly trunk routes, to import aircraft and to set airfares. While early skirmishes over competitive airfares have already generated some excitement in the media, nobody in the airline industry is yet quite certain of what overall impact the changes will have on the marketplace.

In attempting to judge the prospects for success of airline deregulation in Australia, let us look at what was the government’s intent, as expressed in Senator Gareth Evans’s October 1987 statement titled “Domestic Aviation: A New Direction for the 1990s”. In that statement, the intended effects of deregulation were summarised as follows:

- no capacity constraints on trunk routes;
- no control on prices, unless anti-competitive;
- no control on importation of aircraft;
- no barriers to airline ownership (except foreign investment limitations);
- no constraints on entry of new domestic operators to trunk routes;
- application of the Trade Practices Act and the Prices Surveillance Committee;
- guaranteed effective access for new entrants at domestic airport terminals;
- maintenance of existing Civil Aviation Authority safety standards;
- Qantas to regain interlining rights (but no other foreign airline to be given domestic rights);
- relaxation of restrictions on charter flights.

The main benefits expected by the government included greater incentives for existing airlines to operate efficiently and to meet consumer needs, the availability of a wider range of fares and discounts, continued growth in leisure travel and greater variety in types and standards of services.

It is worth considering the realities of airline deregulation in the United States and whether this and other overseas experiences may be relevant to Australia.

It is 11 years since the US passed the Airline Deregulation Act, which provided for a phased reduction (and ultimate removal) of the Civil Aeronautics Board’s regulation of the industry. The CAB’s authority over fares and route access ended on January 1, 1983, and responsibility for evaluating the fitness of new entrants ceased on January 1, 1985.

In the 1980s a tremendous market upheaval occurred, with many new

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Today. The concept spread worldwide during the late 1980s.

In Australia, with Sydney the only major hub, the American model does not appear to be economically feasible. Even though we have a land mass as big as the US, our 16 million people (compared with America’s 225 million) makes widespread hub-and-spoke operations difficult. However, if we look at the Asia-Pacific area, a regional hub-and-spoke system might be feasible.

While some in the United States would say that the deregulation experience has failed, the public has benefited with lower fares on most routes. More than 80 per cent of US airline passengers seek discount fares and have become quite adept at shopping around. The frequent-flyer schemes which some airlines developed to promote customer “loyalty” have produced a good deal of consumer benefit—but sometimes at the expense of business passengers who suffer over-crowded airports and restricted in-flight service because of load factors near 100 per cent.

Despite some accompanying problems, most US airline executives say that a new operating flexibility enables management to optimise the use of aircraft and related equipment, personnel and other assets. Fares and quality of service are matched more closely with market demand and substantial discounts can be introduced to attract discretionary traffic and to shift traffic to off-peak hours. As well, the necessary restructuring of labour practices and pay scales has enabled most trunk carriers to remain competitive with the surviving low-cost airlines.

US deregulation has created something of an oligopolistic market. The success of the mega-carriers has come not only at the expense of smaller airlines but also of trade unions which helped to reduce costs through pay and work-practice adjustments. Service to small towns has been reduced. In 1988 airfares began to rise rapidly and American consumer groups are sure this will continue.

Profits of the mega-carriers increased sharply in late 1988, airline stocks became the Wall Street favourite and many carriers became the subject of takeover bids. Nonetheless, the fact that so many new-entrant airlines have failed over the past few years has meant that finance for airline start-ups is now very difficult to raise and this could influence the outcome of Australian deregulation.

While many of the characteristics of US aviation do not apply to Australia, the principles of encouraging demand through fare reductions and increased competition have been the same. The two-airline policy in domestic aviation regulated access, capacity and prices on a defined trunk-route network of 18 airports in state and territory capitals and other cities.

The trunk routes dominate airline traffic with more than 80 per cent of passengers flying between nine major east-coast ports. Five major trunk routes account for almost 50 per cent of the domestic airline market. These routes with the highest passenger density are:

Sydney—Melbourne
Brisbane—Sydney
Adelaide—Melbourne
Canberra—Sydney
Coolangatta—Sydney

The domestic airline market has grown, at an average annual rate of about 3 per cent, from 10.7 million passengers in 1978/79 to 13.6 million in 1988/89. The average Australian takes about 0.8 of one air trip each year. This contrasts with 2.0 trips for the average American and 1.3 for the average New Zealander.

There is a strong degree of confidence in the outstanding safety record of the domestic carriers and
an appreciation of their high standards of air service. However, most Australians have resisted air travel because of a belief that fares were excessive, particularly on major trunk routes where load factors were high and discount fares were relatively unavailable. As mentioned earlier, the benefits of deregulation initially anticipated by the government included a wider range of discounted fares and access to flying by more Australians.

In considering the potential impacts of deregulation we must look at the possibility of new entrants into the market place as well as heightened competition among the existing airlines.

The matter of airport terminal access is most important to the prospects for new-entrant airlines. In addition, any newcomer to Australia’s commercial aviation environment faces distinct disadvantages. Not only is there the question of adequate start-up funding, but also the need to weather long-term losses and provide “fighting funds” to counter the retaliatory strategies of existing airlines.

Of particular importance for a new airline is the need to create confidence among its potential market. No new operator can afford to appear to compromise on safety or standards. This suggests the need for a fleet of new or near-new planes which will represent a huge investment. Corporate identity and image development for the new airlines will also require much investment. While pricing is obviously important, it is not in itself sufficient to attract customers from other airlines.

Now for some of my observations:

- A well-financed new entrant can gain an advantage in operating costs and thus introduce lower fares while still making a profit.
- Attempts by new entrants to gain any market share in the high-yield business traffic will provoke a massive competitive response from the major carriers.
- Yield management will become a vital marketing tool as discount fares, off-peak scheduling and frequent-flier programs are introduced.
- Deregulation will promote increased competition between the existing major airlines as they strive for control of distribution channels such as business clubs, travel agents, computerised reservation systems and direct advertising.

In general, however, the consumer benefits from deregulation will begin slowly and the full impact may not be felt until the mid-1990s.

The existence of some barriers to competition may force the government into some drastic steps if the full benefits of deregulation remain a serious long-term objective. At least some of the following may be necessary:

- Privatise Australian Airlines (moves in this direction have recently accelerated, despite some opposition within the government);
- Renegotiate airport access for new entrants (this is a particularly difficult issue for the Federal Airports Corporation);
- Provide some form of government intervention to ensure that new entrants are not unduly disadvantaged;
- Allow Air New Zealand to run a domestic airline in Australia (similar to Ansett’s New Zealand operations);
- Allow a partially privatised Qantas to become more active in the domestic market (and perhaps extending international rights to domestic carriers).

It is already obvious that competition is hotting up; one new entrant, Compass, has taken to the air and others are working to determine their place in the industry. The “battle for the skies” is now a reality which neither of the two major domestic airlines can ignore or treat lightly.

Even before deregulation became a reality, the pilots dispute and other developments had changed the face of Australian aviation.

The challenges now being thrown up as existing and potential players test the new and unfamiliar environment promise that the years ahead will be interesting—if not exciting—for those concerned.

COMPETITION – ALL IN THE FAMILY

Australia has about 45 “commuter” airlines, most of them very small, and in theory the deregulation of domestic airlines could see this number rise as new entrants try for a share of the market.

In practice, however, newcomers will find it difficult to break in at the small end of the scale because of existing alliances between most of these commuter lines and one or other of the Big Two domestic carriers. These arrangements mean that any newcomer would effectively be in competition with Ansett or Australian.

In casting their net for the small operators, the Big Two have followed an example set by airlines in the United States, where strong feeder networks are important.

American Eagle, the regional division of American Airlines, uses four wholly-owned subsidiary airlines and three franchised partners to operate more than 1,400 flights a day between 150 cities. This kind of networking under the umbrella of a major airline is considered to provide passengers with better, more reliable service.

In Australia, about 20 of the 45 commuter airlines are associated with Ansett, either by equity or commercial arrangements, and about 15 have links with Australian Airlines. Those which are not wholly or partly owned by the majors may have mutually beneficial ticketing and scheduling arrangements with them. The big airlines gain access to small routes which they could not otherwise service economically, and the small operators are rewarded with access to airport terminals and ground handling.

These closely linked commuter airlines include the top 10 in Australia, estimated by the Department of Transport and Communications to account for between 80 and 90 per cent of total commuter traffic.

Australian Airlines has equity in Australian Regional Airlines (100 per cent), Eastern Australia Airlines (42 per cent) and Sunstate Queensland (33 per cent), and commercial agreements with Hazelton Air Services, Sunstate Mildura and Lloyd Air. TNT and News Ltd, the owners of Ansett, wholly own Skywest and Aeropelican and have 35 per cent of Kendall Airlines. Ansett also has agreements with Norfolk Airlines.