

**Virgin Atlantic Airways response to the Airports Commission Discussion Paper 04:
Airport Operational Models**

Virgin Atlantic is pleased to submit evidence to the Airports Commission. Over 28 years we have grown from a start-up airline to the UK's second largest global airline. We carried 5.28 million passengers and 210,000 tonnes of cargo in 2011.¹ We operate 40 wide-bodied aircraft, serving 30 destinations across four continents from four UK airports. Our "Little Red" domestic operations connect Aberdeen, Edinburgh and Manchester with Heathrow, connecting passengers from the UK regions to the rest of the world.

Introduction

The discussion paper states that "Over thirty years ago the global aviation market was largely fragmented and protected. At the time, both airports and airlines were typically state-owned monopolies and the aviation sector was considered to be of strategic importance in numerous countries". This was the market that Virgin Atlantic first entered in June 1984, with the intention of offering a new, consumer-focussed approach. Nearly thirty years later, the aviation market has changed considerably however, in providing critical air links between the UK and international markets, supporting hundreds of thousands of jobs in the UK economy, and generating significant export revenues for UK plc, the sector should still be considered to be of strategic importance to the country.

Air transport delivers both direct and indirect benefits to the UK economy. The most recent analysis of the contribution to the UK economy found that UK aviation:²

- contributes £49.6 billion (3.6%) to GDP;
- supports 921,000 UK jobs; and
- pays over £7.9 billion in tax.

Aviation drives wider economic growth by:

- connecting British businesses to new customers, investment and opportunities and opening up foreign markets to UK exports;
- encouraging inward investment from foreign firms which require strong international transport links;
- lowering transport times and costs, helping to increase competition because suppliers can service a wider area; and
- supporting the adoption of new business practices, such as just-in-time-inventory management, that rely on quick and reliable delivery of essential supplies.

Many businesses depend on international air travel. British residents made 6.85 million overseas business visits by air in 2011.³ In the same year overseas residents made 5.4 million business visits by air to the UK. Those visitors spent £3.92 billion pounds in Britain.⁴

¹ www.caa.co.uk/docs/80/airline_data/2010Annual/Table_0_1_6_All_Services_2010.pdf

² Oxford Economics, *Economic benefits from air transport in the UK*, 2011, p.4

³ ONS, *Travel Trends 2011*, 26 July 2012, Table 3.03

Air freight represents less than 1% of UK trade products by tonnage, but 30% of exports by value.⁵ A BIS study looking at sources of future economic growth found that specialised and knowledge-intensive service and manufacturing sectors are likely to contribute strongly, building on the UK's relative specialisation in finance, business services, communications, and computer and information services.⁶ These are all sectors that rely on air freight services, so we expect air freight to grow in importance.

Aviation is also vital to meet the Prime Minister's inbound tourism objectives of generating four million additional overseas visitors over the next four years and making the UK one of the top five visitor destinations in the world.⁷ 73% of all inbound visitors to the UK arrived by air in 2011 and their share of inbound visitor spend was 84%.⁸ That is 7.95 million holiday visits to the UK, contributing £5.5 billion spend in the economy.⁹

As well as the connectivity that airlines provide, they are important businesses in their own rights. Virgin Atlantic is the UK's twelfth largest privately owned company, employing over 9,000 people directly and many times that number in our supply chain. Around a third of our £2.7 billion annual turnover derives from overseas ticket sales, representing nearly a £1 billion of export revenues to the UK economy. Whether those passengers finish their journey in London, or carry on via the hub to another destination here or in a third country, their value to the UK economy is surely far greater than the regularly quoted "price of a cup of tea at Heathrow".

The UK has led the way in the liberalisation of air transport; British consumers have uniquely benefited from a second international home-base carrier (Virgin Atlantic) providing competition at the national hub (Heathrow). There is no Virgin Atlantic, offering a competitive challenge to the incumbent former national flag carrier, at any other European hub. The no-frills sector has also driven massive changes in the aviation market. The choices that UK consumers enjoy today, alongside competitive fares, innovative products, and high standards of customer service, are a result of that liberalisation.

⁴ ONS, *Travel Trends 2011*, 26 July 2012, Table 4.01

⁵ www.fta.co.uk/policy_and_compliance/air/air_freight.html

⁶ Department for Business, Innovation and Skills, *Sources of Economic Growth*, Trade and Investment Analytical Papers, February 2011

⁷ www.number10.gov.uk/news/pms-speech-on-tourism/

⁸ <http://www.visitbritain.org/insightsandstatistics/inboundtourismfacts/index.aspx>

⁹ ONS, *Travel Trends 2010*, July 2011, p.45

Do you consider that the analysis supports the case for increasing either hub capacity or non-hub capacity in the UK?

Do focal airports and non-focal airports bring different kinds of connectivity and, if so, which users benefit the most in each case?

Virgin Atlantic believes that the UK needs one internationally competitive hub airport located where people want to fly to, from and via. International connectivity is best achieved through a world class hub airport and point-to-point, or “non-hub” airports. The UK needs both.

A hub airport allows airlines to connect passengers from a variety of destinations to a variety of destinations, on services which would not be commercially viable if limited to point-to-point traffic. The UK can only have one world class hub airport.

Successful point-to-point airports, such as Gatwick, Manchester and Glasgow are essential components of a competitive UK aviation industry but they are not a substitute for a hub airport.

We would suggest that positing this as an “either, or” choice reflects an overly-simplistic view of the air transport sector. As airport infrastructure is currently privately funded in the UK, any solution must command the confidence of the industry and be justified by a robust business case, whilst recognising strict environmental criteria.

To what extent do the three potential futures outlined in this chapter present a credible picture of the ways in which the aviation sector may develop? Are there other futures that should be considered?

Whilst the discussion paper makes an interesting case for the three future scenarios presented, Virgin Atlantic would argue that in reality the Airports Commission and the UK Government has a much starker choice: between proactively supporting the future growth of UK air transport with all the economic benefits, direct and indirect jobs, trade links and competition that brings, or sitting back and accepting that the UK be relegated to the periphery of international transport links.

How are the trends discussed in this chapter (e.g. liberalisation, growth of low-cost carriers, consolidation of alliances, and technological changes) likely to shape the future of the aviation sector? Do they strengthen or weaken the case for developing hub versus non-link capacity?

Consolidation has played a significant role in reshaping the European aviation sector however the proportion of an airline which can be owned by a foreign (i.e. non-EU) investor is limited to 49%. This means that full consolidation, as has been seen in other sectors of the economy, is not currently possible.

In December 2012 Virgin Atlantic announced that Delta Airlines, a major US carrier, would be purchasing the 49% stake in our airline previously held by Singapore Airlines. Just last month (June 2013), on the day on which the shareholding transaction was enacted following merger clearance from the US Department of Justice and DG COMP in Europe, we announced our code share partnership. This opens up a variety of new destinations to Virgin Atlantic's customers travelling to and from North America (and additional UK destinations for Delta's passengers).

In addition, Virgin Atlantic and Delta Airlines revealed plans to enter into a trans-Atlantic Joint Venture, creating an expanded trans-Atlantic network and enhancing competition between the UK and North America. This partnership, which we expect to secure anti-trust immunity approval from the US Department of Transportation within the next few months allowing the coordination of schedules and operations, will include:

- A fully integrated joint venture that will operate on a "metal neutral" basis with both airlines sharing the costs and revenues from all joint venture flights
- A combined trans-Atlantic network between the United Kingdom and North America with 31 peak-day round-trip flights
- Enhanced benefits for customers including cooperation on services between New York and London, with a combined total of nine daily round-trip flights from London Heathrow to John F. Kennedy International Airport and Newark Liberty International Airport
- Reciprocal frequent flyer benefits
- Shared access to Delta Sky Club and Virgin Atlantic Clubhouse airport lounges for elite passengers

This partnership will allow both carriers to offer a greatly expanded network at Heathrow and – to an extent - to overcome slot constraints, which have limited the growth and competitive capability of both airlines. The two carriers will operate a total of 31 peak-day round-trip flights between the U.K. and North America, 23 of which operate at London-Heathrow. The enlarged network will benefit customers of both carriers by providing greater access to a broader network, improved connectivity and convenient booking options.

In 2012, Virgin Atlantic was awarded the remedy slots arising from BA's takeover of bmi. These slots are linked to specific routes - in this case Aberdeen and Edinburgh - and cannot be used for any other services for a considerable period of time. In requiring BA to make these slots available to another airline, the European Commission (DG COMP) intended that competition be maintained on key routes from Scotland to London Heathrow, routes that would otherwise be served only by BA. Despite the pre-existence of services from Aberdeen and Edinburgh to London Gatwick, operated by easyJet, DG COMP saw that access to the hub was essential in order to maintain the consumer benefits that derive from competition not only point-to-point but for a variety of destinations beyond London.

It has been suggested that new aircraft types, such as the Boeing 787 Dreamliner with improved fuel efficiency and a greater range, will undermine the hub and spoke model. Whilst they will undeniably reshape the economics of currently commercially marginal routes and be a key factor in delivering sustainable growth for the aviation sector, services

operated by these new aircraft will still rely on the hub and spoke model. Point-to-point demand for routes served by these aircraft will not always be sufficient; just as today, in order to support existing services to “thinner” markets and to justify new services to emerging markets, the airline sector will be reliant on transfer passengers.

Whilst these recent and ongoing case studies will enable a more efficient use of the capacity constrained hub, or have protected competition on key services to the benefit of UK consumer, they have not been a substitution for additional capacity at the hub.

What are the impacts on airlines and passengers of the fact that the wave system at Heathrow operates under capacity constraints?

Virgin Atlantic, with only three per cent of the total slots at Heathrow plus the remedy slots arising from the BA takeover of bmi, has been unable to take full advantage of the “wave system” in the way that has benefitted airlines holding a higher proportion of slots. A limited number of slots means that our ability to flex the timings of our services, in order to offer attractively-timed connections to support passenger flows between Virgin Atlantic’s long-haul services, is limited. This has had a direct impact on our network and our ability to provide competition (to the benefit of passengers and cargo users) on key routes, especially to emerging economies.

In 2005, Virgin Atlantic launched a service from London Heathrow to Mumbai, India. In 2009, we were forced to withdraw the service as a result of the combined effects of the economic downturn and poor slot timings at Heathrow, meaning that we were unable to offer useful connections to passengers onwards from Heathrow to the USA. In November 2012 Virgin Atlantic re-launched a daily flight between Heathrow and Mumbai, better timed to support onward connections to the US. This key market, whilst representing a minority of passengers onboard, contributes significantly to the commercial viability of this service to the benefit of point-to-point passengers travelling LHR-BOM or BOM-LHR.

The timing of available arrival and departure slots at Heathrow has also factored in our decision to suspend services to Nairobi, Kenya and Accra, Ghana, both key trade partners for the UK. With Accra now only served by one airline from the UK, it is clear that competition has been reduced to the disbenefit of consumers.

How does increasing size and scale affect the operation of a focal airport? Is there a limit to the viable scale of an airport of this kind?

What specific characteristics of the UK and its cities and regions should be considered? For example, does the size of London and the density of route networks support or undermine the case for a dominant hub?

Virgin Atlantic will leave it to the organisations proposing specific solutions to the UK’s hub capacity crisis to demonstrate the operational feasibility of their preferred options. However it has been demonstrated at Schiphol, Frankfurt, Dubai and other major hubs that an airport exponentially bigger than the local market it serves can be supported if proper

emphasis is given to the importance of connecting passengers across a range of different routes (with the associated economic benefits to that country's economy).

Would expanding UK hub capacity (wherever located) bring materially different advantages and disadvantages of expanding non-hub capacity?

A network or hub-and-spoke model ensures the most efficient use of a scarce resource. By consolidating passengers (and goods) from a range of points of origin to a range of destinations the hub ensures the commercial viability of a wider range of routes than could be supported by a purely point-to-point market. This model is used by a number of different industries, from the railway sector (not everyone travelling from Brighton wants to go to London Victoria, many will switch trains at Clapham Junction in order to connect on to another destination in London) to businesses as diverse as courier companies and the major supermarket chains, with their centralised distribution centres.

As airport infrastructure is privately funded in the UK, any solution must command the confidence of the industry and be justified by a robust business case. Virgin Atlantic is confident that the significant advances made in the carbon efficiency of technology combined with innovative sustainable fuels solutions, and the considerably reduced noise footprint of aircraft already entering service, mean that any new capacity can be delivered whilst meeting strict environmental conditions.

What would be the competitive effects (both international and domestic) of a major expansion of hub capacity, and what are the associated benefits and risks?

To what extent do transfer passengers benefit the UK airports and the UK economy? Is there any evidence that the UK (or individual countries and regions within the UK) are disadvantaged by using overseas focal airports?

A former Secretary of State for Transport once asked "does it really matter to UK plc, if a passenger flies on a British or foreign carrier?" Their counterpart in the Netherlands, France or Germany would have asked such a question, as it is recognised that there are four times as many jobs associated with a home-based carrier operating a route, compared with a foreign carrier.

We would suggest that transfer passenger should be divided into two groups: those transferring from a UK airport via a hub to another destination, and those transferring from one third country via the UK hub to another third country.

For passengers living some distance from the UK's hub and for whose intended destination there is no direct flight from their local airport, a connection via a hub is essential. That hub can either be within the UK, in which case it is likely that the greatest degree of economic benefit will remain within the UK, or it can be via a third country's hub.

Virgin Atlantic knows, from our recent experience in securing the remedy slots released by BA as a condition of their takeover of bmi, that UK regions are very concerned about access

to London (particularly London Heathrow) and points beyond, including international markets in the USA, Asia and Africa. Access to these destinations is highly valued by Scottish business and consumers, as was evidenced by the considerable degree of support Virgin Atlantic's bid for the remedy slot received.

As previously described, transfer passengers can make the difference between the commercial viability of a service or its suspension, maintaining essential trade links with the UK. And each ticket sold overseas by a UK carrier – regardless of whether that passenger finishes their journey in the UK or not – represents an export, supporting jobs directly and indirectly within the airline operating the flights.

Could the UK support more than one focal airport? For example, could an airline or alliance establish a secondary hub outside London and the South East, for instance in Manchester or Birmingham?

Virgin Atlantic flies to the world's leading and emerging long-haul business destinations from Heathrow and serves the world's leading long-haul leisure destinations from Gatwick, Manchester and Glasgow. Given the restrictions on our growth at Heathrow, which have existed for all of Virgin Atlantic's 29 years of operation, if we believed more of our long-haul services could be viable from regional airports we would have done that. However point-to-point markets from those regional or secondary airports are too small to support a commercially viable service.

For example, based on the smallest long-haul aircraft currently operated by Virgin Atlantic (A340-300 with 240 seats) a target of an 80% passenger load factor on a daily service would mean 140,160 passenger per annum. Looking at one of our key routes, Hong Kong – a well-established business and leisure destination - CAA passenger survey data for 2010 shows that only 90,211 daily passengers travelled from Manchester airport using either direct indirect services. Even if Virgin Atlantic were to secure every single one of those passengers, it would still represent a shortfall of 50,000 passengers per annum.

To what extent is it possible to operate a successful “constrained” focal airport by focusing on routes where feeder traffic is critical and redirecting routes which are viable as point-to-point connections to other UK airports?

The UK has benefitted from a liberalised air transport market. It has encouraged innovation, allowed new business models to develop, and encouraged competition to the benefit of consumers. The UK is seen as a global model of best practice in this respect.

Reverting to the “bad old days” of traffic distribution rules and Government intervention in the market will be a hugely regressive step. Where point-to-point services are commercially viable from other UK airports, they will be operated. Airlines will identify a market and seek to serve it. Instead the Commission should consider the extent to which the UK could benefit from a higher proportion of transfer traffic, supporting a wider range of services to a variety of destinations not currently viable from a capacity-constrained hub.