

UK Airport Commission

Response to the 'Airport Operational Models' discussion paper July 2013

Submission from

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I am Director of London based air transport consultancy JLS Consulting. I have spent my entire working life in the civil air transport industry beginning my career at British Midland Airways & subsequently working for British Caledonian Airways, British Airways, Air UK, KLMuk & buzz. 10 years ago I established by own independent air transport consultancy. I have witnessed the growth, fragility & structural change of the industry over a 30 year period.

I have extensive experience in network planning and revenue management, the processes by which airlines evaluate market potential & optimum aircraft deployment & then how to maximise revenue and occupancy from that capacity.

- I have worked on the network planning of global airlines (BA, KLM), overseas carriers for whom the UK is a critical market (KLM) and low cost carriers (buzz). I understand what works and what doesn't work for different airline models
- I have worked at London's 3 largest airports, Heathrow, Gatwick & Stansted and understand the differences in their capabilities from an airline perspective
- I have enormous experience of the UK's regional airports, some of whom have been clients in recent years
- This exposure to a diverse mix of airline business models and strategies, as well as my more recent consulting work, has allowed me to develop a deep appreciation of the different market dynamics of each of the UK's airports, to gain an understanding of what they are capable of delivering and not delivering (as opposed to what some may claim they can deliver)
- My views have equally been shaped by my own "road to Damascus" moment, working for a Low Cost Carrier and witnessing at first hand the revolution which they have brought to the short haul airline business and the opportunities which they have provided for more accessible travel throughout the UK

During my career, amongst the key changes which I have seen, I would highlight the following:

- Heathrow reaching saturation point
- The progressive disappearance of many regional domestic flights to London & to Heathrow specifically. It is difficult to conceive that in my early career it was possible to fly directly between Heathrow & Birmingham, East Midlands, Leeds, Liverpool, Teesside & Inverness amongst other UK destinations
- I have seen the emergence of the Gulf carriers, witnessing the development of Emirates since their small beginnings in the late 1980's when they first started to fly to London (competing with British Caledonian, my then employer), to the global force which they represent today
- The rise of low cost carriers has been a fundamental shifting of the tectonic plates for the airline industry. Not only in their market impact, but in shifting the thinking about cost control and resource utilisation amongst other airlines

As a Yorkshire man & as someone who began his professional life in the Midlands, I do not hold a London centric view of the world. However the reality is that for many airlines London provides a very much stronger market than the rest of the UK. Equally, London's airport themselves have significant differences in potential, depending on which airline model is being assessed.

My objective

I commend the Commission for a broad and well constructed overview of the industry structure and issues in this paper.

My aim is to provide you with an informed, personal but no less, valuable input based on my *own diverse* experience of how the industry has evolved over a 30 year period. I do not believe that this diversity of experience is very common. It has also kept my eyes open to new trends and opportunities

Developments in the Industry

Short haul flights

- The cost economics of short haul flights are extremely challenging. For hub carriers in Europe-relying on filling up their long haul services from a variety of short haul points (very different to the experience of the Gulf carriers discussed later) , there is no choice but to operate a short haul network. For these airlines (BA/IAG, Air France KLM, Lufthansa), these services are typically loss making but they are an essential element in being able to fill the long haul capacity at their hubs. If they could obtain this short haul feed without operating short haul services they would do so!
- British Airways has cut back its short haul network to Heathrow over the years, Air France KLM (particularly KLM) and Lufthansa are far more reliant on short haul feed due to their smaller home markets. Both are currently experiencing heavy losses due to the weight of these networks which are increasingly exposed to Low Cost Carrier competition
- All three groups are trying, with very differing approaches and varying levels of success, to create their own low cost affiliates as a means to tackle these losses . I would be pleased to share my views on these approaches and the attendant issues, with the Commission
- A subset of short haul markets are profitable in their own right for these hub carriers, with sufficient “point to point” traffic and higher fare business customers, but typically it is the very cost efficient Low Cost Carriers (LCC’s) who can achieve genuine profitability from this market segment
- The zealous attention to cost control & the avoidance of complexity required to handle transfer passengers allows LCC's to operate profitable short haul services where traditional airlines cannot do so. Nor do they have to provide capacity on busy flights for long haul transfer passengers or compromise by prorating (sharing out) revenue between short haul and long haul flights, as do the hub carriers. This latter point is a key reason for the large losses incurred by hub carriers on their short haul operations
- The decision by Flybe to sell all its Gatwick slots poses issues for some UK regional cities but it also illustrates the lack of profitability of short haul domestic flights outside of the low cost model, (Flybe cannot be defined as a LCC) and if there is no feeder benefit to the operating carrier
- There are very real differences between LCC's. Ryanair, for example, is the most “extreme” version of the model, focussing on point to point passengers and serving largely secondary airports. easyJet, on the other hand, also focuses on point to point traffic but has a clear strategy to attract business passengers willing to pay higher fares. (This difference in strategy was clearly described by Carolyn McCall in her witness statement before the Commission). It predominantly uses primary airports such as Gatwick &

Manchester where it is able to compete (& in some cases replace) traditional airlines on many short haul routes

- It was also made clear by Carolyn McCall that easyJet does not wish to become involved in the costs and complex infra structure of transfer traffic. With the recent purchase of Flybe's Gatwick slots, easyJet will hold close to 65% of movement capacity at the airport. This will have implications for the airport's future ability to truly function as a "seamless" hub
- A small number of niche markets with low volumes of traffic & where customers are prepared to pay for the convenience & speed which a direct air service brings can also be sustained profitably. These tend to be flown by small aircraft (usually turbo prop equipment) at typically higher fare levels. Examples include the introduction of services between Birmingham, Manchester & Inverness. These have been a catalyst to business development in the Highlands economy, making possible journeys which were not realistically achievable by surface in meaningful time periods for business users

The Gulf carriers

- The “big three” Gulf carriers enjoy almost perfect geographic positioning to connect the growth markets of the 21st century
- They have fleets of the most modern ultra long range aircraft available, allowing them to connect with any airport in the world on a nonstop or one stop basis
- While they rely on connecting traffic, most of this is long haul to long haul. This typically provides a better relationship between ticket price and the costs of operation than the European reliance in short haul feed (described earlier), thus they are able to avoid carrying heavy losses from the maintenance of short haul networks
- Emirates, the oldest and most mature of these carriers, has the largest fleet of high capacity Airbus A380's in service and on order and the world's largest fleet of ultra long range Boeing 777's, a very efficient twin engine aircraft
- Its strategy is to open new routes on a daily or close to daily basis. Given the sheer scale of its Dubai hub, this means that every new route opened or frequency added, serves to strengthen the performance of *all* existing routes by adding multiple new journey permutations for customers onto the Emirates network
- The Gulf carriers are truly tapping into the new growth markets and traffic flows of the 21st century. In particular Emirates offers an extensive African & Asian network & can offer connections between the two. It is fair to say that from a simple geographic perspective, European carriers will never be able to tap into certain of these flows, e.g. China-Africa

- However, in those growth markets which should be able to be served on a geographically logical basis, such as Europe-Asia, UK based airlines are being heavily handicapped as indeed are the wishes of foreign carriers to provide services, due to the severe capacity constraints faced in Heathrow
- In terms of airport capacity, Dubai will grow its existing airport up to around 2020 before looking at a 100% move for Emirates' services to the new Dubai World Central Airport at Jebel Ali (which is already built). Qatar is about to open a brand new airport and Abu Dhabi has spare capacity
- In all above examples growth is a) taking place b) being concentrated on existing assets to preserve airline optimum efficiency of operation for connections as well as to protect economies of scale by operating at the *same* airport
- Without going into much detail here, Turkish Airlines is also now successfully emulating the activity of the Gulf carriers though there will be a requirement for a new airport in Istanbul to accommodate growth

Low Cost Longhaul

- This concept is not yet well established and is far from proven
- It is not possible to benefit from the same economies of scale, efficiencies and productivity improvements employed by short haul LCC's
- Several attempts have failed (e.g. Zoom in Canada, Oasis Hong Kong)
- The most successful to date has been Air Asia X based in Kuala Lumpur and it relies extensively on feed from its regional partner Air Asia
- Norwegian has just launched long haul low cost services with the new efficient Boeing 787 but only time will reveal whether it is able to succeed. It also plans to feed from existing short haul services
- I am not convince that this concept will be broadly adopted and happy to explain in more depth to the Commission my thinking on the topic

Can the UK support more than one focal/hub airport?

- It is not realistic to assume a regional airport can fulfil a broad hub airport role, it has to be London & due to the need for adequate dovetailing of long haul & short haul capacity for connections, airlines will allocate their aircraft to the most profitable opportunities and the evidence for London is that for long haul operations they chose Heathrow. From my own personal experience, I recall witnessing the stark contrast in the amount of high yield (revenue) traffic which my employer British Caledonian was able to achieve on its long haul routes at Gatwick in the late 1980's, as compared to British Airways on comparable Heathrow routes, when it bought the airline. We were able to fill our business cabins on destinations such as New York JKF, one or two days per week, with a daily flight. By contrast, British Airways had more than twice the average business capacity per flight on multiple daily frequencies from Heathrow. These were close to full on practically every flight, on most days of the week, with many more potential passengers on the waiting list
- When traffic distribution rules were relaxed in the 1990's, airlines such as Air New Zealand and Cathay Pacific moved to Heathrow
- Similarly when the US-EU Open Skies Agreement was concluded in 2010, the remaining airlines operating US services at Gatwick moved them to Heathrow, some even paying millions of pounds for slots in order to do so
- A comment worth making at this point is that Air France took advantage of the of the new accord to launch its own Heathrow-Los Angeles service, as did its US partner Delta (then Northwest), to Seattle. Both services were suspended after failing to perform in the absence of feed from the carriers' home hubs, indicating that even with the strength of Heathrow's point to point market, feed traffic is still necessary
- Stansted is now running substantially below capacity as LCC's have cut back their services. Long haul airlines want a range of connection options which Stansted cannot provide, due to the point to point nature of its LCC airline customers
- A small number of long haul airlines are now using Gatwick (including British Airways with some niche leisure orientated routes to Florida, Mexico and the Caribbean), but not all have worked as airlines struggle with an adverse yield (average fare) difference which may be up to 20% as compared to Heathrow
- Air Asia X, which uses a low cost model, did see better self connecting opportunities at Gatwick for its Kuala Lumpur service which it switched from Stansted (its customers made their own connections at their own risk) with easyjet having a larger operation there than at Stansted. However it abandoned its service due to rising UK APD
- Korean Airlines recently added additional capacity to Gatwick after being unable to secure suitable extra slots at Heathrow but at the time of writing has only been willing to operate a seasonal summer service

- Aero Mexico, by contrast, waited several years to secure slots at Heathrow rather than choose another London airport
- Other examples of the difficulty airlines have in launching long haul capacity in the London market include:
 - Stansted lost a New York Newark service which was cancelled after the 9/11 attacks
 - Prior to the financial crisis and recession, three different business class only airlines were launched, all with somewhat different product propositions, two from Stansted, one from Luton. All three went bankrupt
- **Aircraft are expensive but highly mobile assets.** The LCC's Ryanair & easyjet have demonstrated this extremely well with their pan European operations. Aircraft are based all over Europe but if a given market does not work or adverse changes are made for example to tax regimes, which impact revenues, then they are moved between bases and countries to exploit other opportunities
- The same is true of long haul aircraft, they can be moved almost anywhere on the globe. *If an airline cannot get access to London or even the airport they are seeking, then accepting a regional alternative is highly unlikely. More probably an air service will be lost to the UK, particularly to important new growth markets where demand is rising rapidly both for the UK as a trade partner & for inbound tourism to the UK*
- Regional, or indeed London airports, will not succeed in obtaining new long haul flights unless they can successfully convince airlines that there is sufficient demand to fill available capacity and to do so at unit revenues (yields) that make sense to the airline in its capacity deployment decisions
 - A recent example which illustrates how airlines will move their aircraft globally was Emirates' commencement of a new Dubai-Seattle service in 2012. They had endeavoured for a lengthy period of time to obtain rights from the Canadian authorities for a Vancouver service but were refused. The USA gained a route at Canada's expense

Challenges of operating flights from the regions

- There are big differences between London & the regions in terms of what air services are commercially viable

Regional Short haul

- Looking at short haul services, overall volumes of traffic are lower and whilst on certain routes the proportion of business travellers may be higher, those paying higher flexible fares are typically fewer than in London
- Leisure travel is more volatile, particularly in the current economic climate & more markedly seasonal than in the London catchment area. For this reason it is primarily price focussed LCC's who have succeeded in growing a regional presence. Even they have had to reduce periods of operation throughout the year on some regional services as recession has made demand much more peaked. Other than their presence, which has grown dramatically over the last 15 years, activity is largely confined to holiday charter flights to summer focussed Mediterranean destinations
- There are some smaller business routes but these survive due to working with specific sectors such as the oil industry (e.g. Eastern Airways) or because operators are feeding their own hubs in Europe such as Amsterdam, Paris & Frankfurt
- Evidence of the difficulty in sustaining success in the regions is shown by the demise of bmiBaby-a subsidiary of bmi. It was a small regionally based LCC which closed when the parent company was sold to IAG
- Flybe, which is a largely regionally based airline, recently announced a sharp increase in losses due to the impact of APD and despite a young modern fleet, will focus mainly on Southampton. According to a recent investor briefing, 70% of its activity is now outsourced, flying on behalf of other airline customers. It has needed to cut its exposure to regional flying
- During my time at KLM's UK subsidiary most regional services to Amsterdam, with perhaps the exception of Manchester, operated with *the majority* of passengers making connections onto other KLM services at Amsterdam Schiphol Airport. It did mean however that small (economically disadvantaged) communities such as Teesside & Humberside enjoyed a very high frequency service for local passengers travelling to Amsterdam, however few there may have been. These services would not be operated were it not for the valuable feed traffic generated to KLM's onward network. *It provides a clear illustration of why connecting passengers are critical to the success of many routes & a number of airline business models*

Regional Long haul

- Long haul services in the regions, other than leisure services e.g. to Florida, are limited to two axes for regular scheduled services, the USA & Middle Eastern/Asian markets
- Other than leisure destinations, these are not operated by any UK carriers- British Airways long since pulled out of long haul regional services
- There is a reason for this-*direct regional long haul services are very difficult to operate with any financial success*. During my period at British Airways services between both Manchester- New York & Manchester-Hong Kong (as an extension from London, supported by a large but price sensitive Chinese community in Manchester), were operated. These services relied on point to point traffic; load performance was poor & very much driven by low fares with few high revenue business customers
- Thus in essence it was possible, on occasion, to fill the plane but not to return a profitable result
- There has been some success with regional services to the USA, particularly from United Airlines (formerly Continental Airlines) to New York Newark. This success has been due in part to the ability to use small & less costly aircraft (Boeing 757, 2 engines & less than 200 seats) It has also been because *the airline has not been selling only New York but 100's of other destinations in the USA beyond this entry Gateway*, i.e. using its own hub model at Newark
- Nevertheless the fragility of regional services is demonstrated with the termination of United's (previously Continental) Bristol service in 2010 & near termination of Belfast. Selling connections beyond New York is less profitable than point to point & there has been the same difficulty in filling sufficient business class seats to assure profitably
- The Belfast service was almost cancelled until agreement was reached with the Northern Ireland Assembly to lower APD, such is the price sensitivity versus competing services from Dublin, with a lower tax regime
- Smaller new generation aircraft such as the Boeing 787 and Airbus A350 could help lower costs but will not alter market dynamics & are, in any case, larger than the Boeing 757's they would replace
- It is worth noting at this point, that in the absence of a direct New York flight from Bristol, most customers would have to travel up the M4 to Heathrow. Were a future hub/focal airport to move to the east of London, journey times & economic access would be significantly worsened
- Newcastle Airport also had the experience of a New York route being announced by American Airlines, only for the service to be cancelled before it began, due to fragile economic conditions
- High and rising levels of APD have also weakened any prospect of further growth in many such services from the regions

- Emirates provides an excellent illustration of the importance of a powerful hub in order to make regional long haul services viable. The airline offers Dubai services from Birmingham, Manchester, Newcastle & Glasgow. The *minority* of traffic is actually going to & from Dubai but *the power of its hub* there is what drives the airline's success from the UK regions
- Some of its regional services are underpinned by large ethnic communities from India & Pakistan living near airports such as Birmingham and Manchester & for whom a journey via a Gulf hub is a convenient & cost effective way to travel home
- Given the challenges of seasonality and low volumes of business fare traffic it would be a fallacy to believe that a meaningful regional hub can be sustained. Despite capacity constraints at Heathrow long haul carriers are not rushing to utilise regional capacity except in those limited cases explained above

How important are transfer & transit passengers to the UK economy?

- Major UK carriers such as BA & Virgin cannot offer the scope and scale of direct services-capacity & frequency from which the UK benefits, without transfer & transit passengers. They are the branch lines which feed the major routes & make the difference between profitability & loss. Also as explained this is exactly what the long haul competitors of these airlines are doing too, both in Europe, the USA and the Gulf
 - transfer passengers contribute directly to the profitability of the two UK long haul hub airlines & by boosting the scale of their route networks, directly generate greater overall employment in their UK workforces and amongst their suppliers
 - this has a strong positive impact on the wider UK economy in providing wider and faster direct access to global markets

Does it matter if passengers use a foreign rather than a UK hub airport?

- A hub airport is a key national strategic asset which allows the UK to shape its own destiny rather than being held ransom to the commercial strategies of overseas airlines or transport policies of foreign government.
- It is incorrect to assume that there is no need to have options of services from, or via London-there are risks in relying on regional hub services provided by overseas carriers
 - The Belgian airline Sabena went bankrupt resulting in the loss of many regional services to Brussels & the onward connections which they provided. The airline's successor, SN Brussels Airlines (partly owned by Lufthansa) recently cancelled its Newcastle-Brussels service for commercial reasons
 - KLM also recently suspended services from Liverpool to Amsterdam

- On a day to day basis the ability of airlines to “turn on & off the taps” for price & seat availability (the role of Revenue Management, in which I am experienced), to the UK market using overseas hubs is another factor which emphasises the importance of protecting direct UK hub market access
 - On high load factor flights, (most long haul services operate >80% full on average), airlines will pick & choose between which traffic flows (customer journeys) it will accept on its flights. They will select those paying the highest fares & in the strongest currencies relative to its remittances. This means that UK travellers cannot guarantee that they will necessarily always be able to obtain a seat for a given itinerary or at an affordable price. When there is competition for finite seats, the airline will make available capacity only to the most profitable traffic flows. *I would be delighted to explain this in more detail to the Commission*
 - These methods are also used by airlines flying directly to destinations out of London but the difference being in this case that the local point to point market represents a larger share of traffic and typically generating higher revenues than connecting traffic *on a given route & so, de facto, obtains much better seat access.*
 - If there is insufficient capacity to serve these markets directly from London, then travellers in the regions are at the mercy of traffic flow management by the small number of carriers providing direct long haul services (or access to them via European hubs) to regional airports & also on their commercial decisions on whether to maintain these services
- As highlighted above, the importance of having UK based hub carriers is also critical because of the much larger number of jobs & jobs of a high quality created by the size of an airline like British Airways
 - Having a large scale home based operation in the UK generates a requirement for everything from check in & loading staff to pilots & skilled engineers (remembering its large engineering base in Cardiff too). Overseas airlines may need to resource or outsource the handling (check in, loading, catering) of their UK services but generating no more than a few direct jobs for this purpose
- To reiterate, the option of foreign hubs has a value but it is one of competition & choice & not one of substitution. The practical illustrations of airlines pulling off or reducing UK services, particularly in the regions (recent examples also include cancelled direct routes by Cathay Pacific, Singapore Airlines and Continental) show why it would be a serious strategic mistake to rely on foreign hubs

Futures

The airline industry has faced a long term problem with instability & inadequate levels of profitability. There are signs that this is beginning to be addressed with moves to consolidation in the last few years. Airlines are being more commercially rationale and astute with regard to capacity provision and attentive to the cost/revenue equation when making route decisions

In the "full service network carrier" market segment we have seen the merger of major American carriers Delta & Northwest & Continental & United, American Airlines and US Airways will be completed shortly. Here in Europe we now have three main global airline groupings, British Airways/Iberia (International Airlines Group, Air France/KLM & the Lufthansa Group. In the Middle East there are the three large global players, Emirates, Etihad & Qatar Airways. In Latin American the first major merger has been concluded between LAN (originating from Chile) & TAM (Brazil)

As Governments reduce their involvement in the running of the sector other such groupings are likely to emerge, for example in Asia

- These will increasingly represent global groupings offering extensive route networks not bound by national identity, the new Emirates, Qantas partnership is an illustration of this
- As such competition will be at a global level
- I have not touched on the issue of alliances here but they are a proxy for closer collaboration/consolidation. They are fluid by nature and will, I believe, reduce in importance as liberalisation increases around the world
- This has implications for airport capacity planning e.g. bmi was owned by Lufthansa and was part of Star Alliance which uses Terminal One at Heathrow. It is now owned by IAG, part of oneworld and which is centred on Terminal 5
- This should bring greater stability & more long term financial security to the industry which will be of benefit to consumers too
- Such carriers will choose to operate fewer short haul flights-because these are typically unprofitable for such "full service carriers" & operated primarily due to a need for "feeder" passengers.
- More of these feeder passengers should be delivered by direct rail into key hub airports and this needs to be part of UK strategy
- It remains an open question whether there will be much development of feed by LCC's onto long haul services in the UK market. For it to happen there would need to be ways found to avoid cost increases for the LCC's and avoidance of risks coming from delayed flights and missed connections
- Smaller more efficient long haul aircraft coming into service such as the Boeing 787 & Airbus A350 will facilitate the introduction of more direct services which will make some new regional markets viable & could conceivably reduce *some*

pressure/necessity on hub airports but they will, in my view, lead to modest rather than radical changes in air service provision to the UK regions

- They will certainly facilitate the opening of more direct services to the London market, provided airport capacity is available
- Over the next 20 plus years there will be a need for intensified connections to the Middle East, India & Asia. Stronger links to other rapid growth areas such as Latin America & newly developing African countries should also be factored into planning (KLM for example recently launched direct services to Rwanda, there are none from the UK). These new generation aircraft will be key to this development
- Low cost carriers are likely to continue to increase their share of short haul markets where there is profitable volume & will still operate in many city pairs but this will be largely mutually exclusive to the requirement of the need for functioning hub capacity

Concluding comments

- Everyone would prefer to travel point to point from their local airport! For customers it means shorter & simpler journeys, for airlines too it is more efficient, less costly & less complex. However, for the reasons outlined, and particularly for long haul destinations, this model will remain a necessity
- The UK only has two home hub carriers, British Airways and Virgin, both of whom support development at Heathrow
- Equally the difficulties of attracting overseas carriers to London, if they cannot get capacity at Heathrow, are evident. For many, the question of even considering other parts of the UK does not even arise. This comes down to fundamental airline economics and the new generation of cost/profit focussed airline management who have to get the best return from their expensive but mobile aircraft assets
- For these reasons the UK will continue to support only one London hub or focal airport
- To dilute a hub would be to destroy its efficiency
- This still means that there is a necessity to develop Stansted and Gatwick both for long haul and short haul traffic. Smaller next generation aircraft such as the Boeing 787 and Airbus A350 reducing in some cases, reliance on feed, are likely to play a role here. The biggest challenge will be whether the negative revenue differential experienced on long haul services to these airports can be reduced
- There are enormous challenges to the development of Heathrow and in an ideal world a new airport would be preferable but the impact on airlines, direct and indirect employment, business travel plans and access are formidable challenges in themselves
 - Certainly there is need for better resilience but this will not be achieved by simply attempting to spread out activity between airports beyond the natural commercial choices made by airlines

My motivation in making this submission is to contribute to this process and help ensure that the right choices are made for UK plc and its opportunities to strengthen its position in the 21st Century economy.

It is evident that the choices are complex and difficult but in order to succeed, they need to be seen to be realistic to and hence supported by the airline community regardless of specific business model . I am based in London & would be delighted to follow up with the Commission to offer additional insight, explanations & assistance as the consultation progresses continues.

John Strickland

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