Air New Zealand and Qantas Joint Arrangement

Further submission from Gullivers Pacific Group

Introduction

We would like to take advantage of the extended deadline for submissions to clarify our concerns, and to urge the Commission to give appropriate attention to the issues we raise during the investigation stage. We would welcome an opportunity to meet with the Commission staff ahead of the draft determination.

We also note that the application does not differentiate markets by functional level. We believe this is an important oversight, and urge the Commission to adopt its past approach of identifying a separate market for the distribution of travel services.

In essence, our concern is that the proposed joint arrangement would, compared to the counterfactual, enable Air New Zealand to use its market power to reduce competition in the travel distribution market. This, in itself, will have detriments. Equally importantly, diminished competition in the travel distribution market can be used by a dominant air services provider to diminish competition in the air travel market.

Competition in the travel distribution market

Recent technological developments with electronic ticketing and on-line bookings have reduced costs and enabled airlines to undertake more direct distribution. Against these developments, complaints by independent travel services distributors have been seen as self-interested pleading, complaining about erosion of their position due to technological advances. This view is based on the presumption that airlines have an incentive to promote as efficient a distribution market as possible to enhance their sales. Under this presumption, airlines would not wish to reduce competition in the distribution market below efficient levels, as it would hurt their sales of air services. Hence, their observed behaviour with regard to independent travel agents has been assumed to be efficient.

However, the above view only holds when air services markets are competitive. To the extent that airlines have market power, they can use travel services distribution arrangements to enhance that power, and to create barriers to entry and expansion by competitors. In essence, under such circumstances, airlines would be willing to accept a degree of inefficiency in the travel distribution arrangements in return for higher monopoly rents. The greater the degree of market power possessed by an airline, the more incentive it has to undermine the efficiency of the distribution market to protect and enhance that market power.

We believe that Air New Zealand and Qantas have already used their market power in various segments of the air services markets to reduce competition in the travel distribution markets in New Zealand. This trend will accelerate if the joint arrangement comes into place.

How distribution affects competition in air services

A competitive independent travel services distribution market contributes to competition by:

- Reducing the costs of comparison shopping;
- Making it harder for airlines to pursue price discrimination strategies through complex fare structures.
- Reducing the costs of entry for new competitors in the air travel services market;
- Enabling the distribution of services by other airline service providers with only marginal presence in the New Zealand market, whose scale would not justify an independent distribution network.

Domestic air services

By forcing a reduction in the number of independent travel services distributors, Air New Zealand operating under the joint arrangement could gain considerable control over the type of entry strategies that would be available to potential new competitors. In particular, this would force potential competitors to put in place fully developed own distribution networks from day one. Since there are significant economies of scale in travel distribution, this would make it harder for entrants to gain a toehold in the New Zealand market. For example, it costs about the same to develop and run a web site accessed by a 1,000 people as by a 100,000. Full-scale entry may become the only option.

Under a competitive domestic market, no airline would be willing to risk not being represented by independent distributors, as this would enhance the sales opportunities of other airlines. Hence, even though they may pursue own distribution arrangements, they would ensure that it was viable for independents to sell their services. As the market becomes progressively less competitive, this constraint disappears. This can be clearly seen from the current practice, under which Air New Zealand offers higher remuneration to distributors on “competitive” routes than on “non-competitive” ones. With the dominant airline service power gained under the proposed joint Air New Zealand-Qantas arrangement, Air New Zealand would have little to lose from restricting the range of outlets through which its services were sold. While this would inconvenience many customers, they would have no alternatives available to them. Air New Zealand would, in any case, have an incentive to restrict its capacity. The most profitable way to manage such a restriction would be through the reduction in independent distribution channels.

Overall, under the proposal, a less efficient distribution arrangement in the domestic market would enhance Air New Zealand’s ability to exercise its market power in the air services market.

International air services

While Air New Zealand may not currently have any market power on many international routes, it may be able to acquire it by reducing the efficiency of the distribution market. As we pointed out in our earlier submission, the key factor here is scale. If independent distributors are no longer able to sell domestic and trans-Tasman services profitably, many of them would not be able to survive by only selling the long-haul routes on other airlines, or the services of airlines not represented in New Zealand. The reduction in the network of independent distributors would reduce the ability of other airlines to sell into the New Zealand market. This would benefit Air New Zealand in two ways:

- On routes where there is a direct competitor (e.g. Singapore Airlines to Singapore), the loss of distribution efficiency would disproportionately affect the competitor. This is because many passengers would still need to access Air New Zealand for their domestic travel arrangements, and hence are more likely to make bookings for the whole journey using Air New Zealand's own distribution network. The alternatives facing the passenger would be: (i) making a single transaction using Air New Zealand's own travel distribution channel (ii) making two separate transactions, as well as facing the inconvenience of the reduced independent distribution network.
- On routes where there is no direct competitor (e.g. Malaysian Airlines to Kuala Lumpur), Air New Zealand would benefit by making that destination relatively less attractive than an alternative Air New Zealand destination. For example, to the extent that Singapore and Kuala Lumpur are competing transit destinations, Air New Zealand could increase the costs of using Kuala Lumpur through its dominance of the distribution network in New Zealand. For example, if only a few, specialised agents offered Malaysian Airline services, the search costs of using that routing would be greatly increased.

Conclusion

While independent travel services distributors would suffer first, we believe that the proposed joint arrangement would create significant public detriments through its likely negative impact on our industry. Under the arrangement, an already powerful Air New Zealand would have an incentive and the means to enhance and maintain that power by reducing the efficiency of the travel distribution market.

Over the coming months, we will attempt to quantify these effects. In the meantime, we urge the Commission to give these issues adequate attention in the draft determination. We look forward to an opportunity to discuss our concerns.