Effects of Fifth Freedom Carriers on Tasman Competition

19 August 2003

Fifth Freedom Airlines

There are 9 Fifth Freedom Airlines with scheduled service on the Tasman in NW03

Fifth Freedom Carrier Seat Share				
Carrier	**AKLMEL**	**AKLBNE**	**AKLSYD**	**Total**
Emirates	**22.7%**	**18.4%**	**7.3%**	**13.9%**
Thai Airways		**11.5%**	**9.8%**	**10.9%**
Malaysian		**8.0%**		**8.0%**
Garuda		**6.1%**		**6.1%**
Royal Brunei		**5.5%**		**5.5%**
LAN Chile			**3.2%**	**3.2%**
Aerolineas Argentinas			**2.5%**	**2.5%**
Royal Tongan			**1.3%**	**1.3%**
Polynesian			**1.2%**	**1.2%**
TOTAL	**22.7%**	**49.5%**	**25.3%**	**32.0%**

Together, these airlines will represent 32% of capacity in the citypairs they operate and 20.4% of total Tasman capacity

- Annual O&D passenger share at Jan 2003 was 16.7% for AKL-SYD and 22.1% for AKL-BNE (before EK and BI entry)

Effect of Fifth Freedom Carriers

Fifth freedom carriers' pricing affects Air New Zealand pricing in two ways

- Revenue Management - Forces allocation of more discount seats due to siphoning off demand from Air New Zealand
- Pricing - Sets the base price point that the market perceives as a "good deal"

Revenue Management

Revenue Management attempts to optimise revenue by filling the most seats at the best prices

- If forecast demand is high (i.e. flight is going to be full)
  - Less seats will be allocated to discount fares
  - Revenue management objective is to increase yield
- If forecast demand is low (i.e. flight is not going to be full)
  - More seats will be allocated to discount fares
  - Revenue management objective is to fill empty seats

The key inputs to revenue management are

- Demand forecast - based on booking pace and trends
- Fare values - grouped together into booking classes

Revenue Management

Example: Expected value of a seat sale

- A 50% probability of selling a $1000 fare
- A 100% probability of selling a $500 fare

As the probability of selling the $1000 fare decreases, its expected value decreases, and seats are reallocated from the $1000 bucket to the $500 bucket

Revenue Management adjustments can be manual or automatic

- The system will automatically allocate more seats to discount classes as the forecast weakens and vice versa
- Manual adjustments are made if an analyst knows of something that will impact demand, e.g.
  - Bledisloe Cup game in Christchurch - less discount seats
  - Significant increase in competitive capacity - more discount seats

Revenue Management

Revenue Management is applied to a scheduled level of operations

- Capacity and costs are fixed in the short term
- Maximising revenue maximises profit

Over time if a sector is not profitable, the scheduled capacity must be adjusted

- Flights perpetually not filling $\Rightarrow$ decrease capacity
- Flights only fill at prices that are not profitable $\Rightarrow$ decrease capacity
- Flights continually full and spilling traffic $\Rightarrow$ increase capacitiy

If passenger volume and yield decreased to unprofitable levels on a sector, Air New Zealand would be compelled to reduce capacity

Price Impacts

Fifth freedom carrier fare levels set the benchmark for passenger perception of a “good deal”

- Example from Tasman Express launch:

  “We had already been selling trans-Tasman airfares on full service carriers for lower prices for some time, that don’t require travellers to pay a service fee to get personal service. We were recently selling airfares to Sydney for as low as $299” - David Burns, General Manager Flight Centre (NZ Herald 13 August 2003)

The greater the difference from fifth freedom fares, the less market share Air New Zealand will capture

- Advantages in network, FFP, and product (if any) would eventually be offset by fare differential

Price Impacts

Wide price discrepancies cannot be sustained across different Tasman city pairs

- Passenger resistance and ill will
- Opportunity for passengers to undercut O&D fare by building itineraries using Domestic Express fares and fifth freedom Tasman fares
- Fifth freedom carriers can move capacity to other citypairs if opportunity persists