

Submission to the NZ Commerce Commission on:

## Commerce Act 1986 – Section 58 Application by Air New Zealand and Qantas Airways Ltd

Prepared by: **Gerard Murphy MBA**  
Director  
Bon Voyage Marketing Ltd  
Auckland

14 February 2003

## Company Background:

Bon Voyage Marketing Ltd is a travel company operating as **Bon Voyage Cruises and Travel** and **e-travel.co.nz**. The company has been trading for 9 years and operates as a personal travel consultancy for leisure and business travellers and a retail travel agency. The company is totally independent in ownership and operation.

Gerard Murphy has been involved in the travel industry for over 20 years and has held roles from Travel Consultant through to General Management in wholesale and retail travel companies and travel groups, prior to forming this business. Gerard holds tertiary qualifications in travel consultancy, marketing and management.

## This Submission:

This submission looks at the effects of the proposed merger on New Zealanders travelling both domestically and internationally, as this is the main area of our business operation. We leave those more involved to address the ramifications of the proposed merger on the inbound tourist market.

No doubt this merger proposal makes great financial sense to the executives on performance bonuses, board members and shareholders of the respective carriers. It is hugely enriching to all those parties but at a huge cost, we believe, to the New Zealand consumer.

Our view is that the proposed merging of Air New Zealand's and Qantas' New Zealand based operations and Qantas' shareholding in Air New Zealand should not proceed for the following reasons:

- The proposal is plainly anti-competitive.
- The proposal has no real consumer benefit for New Zealanders, in fact the opposite.
- The proposed merger is not in New Zealand's national interest – tourism and/or employment.
- The proposal will result in a market dominant virtual monopoly, forcing structural changes detrimental to the sustainability of the NZ travel agency sector and to services to the consumer.

The balance of this brief submission expands on these points.

## PART 1-a The Competitive Environment - Domestic

The New Zealand domestic aviation market is currently made up of three main national operators, Air New Zealand, Qantas and its regional partner Origin Pacific as well as many local airlines.

The history of domestic airline competition is well known. Prior to the advent of Newmans Air / Ansett New Zealand our country suffered from the monopoly power of Air New Zealand.

The consumer benefits from the new competition were many and included;

- New routes and increases in frequency
- Jet services to major tourist destinations of Rotorua and Queenstown
- Improved and new aircraft
- New airport terminals
- Air-bridges
- Frequent Flyer Schemes
- Meals and snacks (with taste) on board
- Price competition for individuals and most importantly for companies

The benefits of real competition in New Zealand can only be saved by having at least two main airlines in open competition in the domestic market.

The argument that the nation cannot economically support more than one main domestic carrier is flawed. It is largely based on Ansett New Zealand's continued struggle with profitability, the demise of its successor the Qantas franchisee Qantas New Zealand, and publicity releases from Air New Zealand.

It is well known that Ansett New Zealand was near to achieving profitability even with the financial legacy of excessive start up capital expenditure and apparently expensive aircraft lease costs charged by its parent company Ansett Australia.

This argument also makes the assumption that both companies were well managed. This is now of course widely debated.

The arrival of Virgin Blue in Australia has proven that a well managed company using modern aircraft can operate successfully and profitably even within markets of relatively small populations e.g. Adelaide, Cairns, Canberra, Coff's Harbour to name a few. The US experience with the growth of the small regional carriers to secondary cities confirms this.

### Recommendation:

**If the proposed merger is to take place we recommend that Air New Zealand and Qantas should be forced to maintain competition in its current form (by retaining two distinct airline operations) until such time as any new operator reaches the current size of Qantas' main trunk operation, i.e services between Auckland, Wellington, Christchurch and Queenstown, with equivalent number of aircraft and frequency.**

Services to other Qantas destinations (Dunedin, Hamilton, Invercargill, Nelson, Palmerston North and Rotorua) are operated by Origin Pacific, and company founder and owner Robert Inglis has already stated that they intend to continue these regional services regardless of the merger outcome.

## PART 1-b The Competitive Environment - International

New Zealand's geographic position forces New Zealand's travellers to be more dependent on Air New Zealand as our national carrier than many overseas countries. Air New Zealand is the only carrier flying to all the main Pacific Island and Pacific Rim destinations, and Pacific Rim connecting hubs for long-haul travel.

While plenty of competition exists from Asian carriers to their home ports and beyond to Europe, the proposed merger will seriously limit competition on Trans-Tasman routes, and all but eliminate competition to points to the East of New Zealand including USA, Canada, and the Pacific Islands. The potential effect on New Zealand travellers could be pronounced.

As there is no guarantee that new or existing competitive carriers will move quickly to add new or additional services it is our view that approximately to 65% of New Zealand travellers<sup>1</sup> will be directly affected by this new monopoly carrier.

<sup>1</sup> A total of 846,458 New Zealanders travelled to North America, The South Pacific Islands – Fiji, Cook Islands, Norfolk Island, Samoa and Australia. Total departures from NZ 1,292,979 Source: Asmal Y/e 31 Dec 2002

In addition we expect a combined Air New Zealand / Qantas will have greater than 50% market share to Asia destinations of Singapore, Hong Kong, Japan, Taiwan accounting for a further 5% of the total NZ outbound market.

**Having approximately 70% of New Zealand's total outbound market under the management control of Air New Zealand is in our view unacceptable in terms of price competition and choice of routes and services.**

Further Air New Zealand and Qantas (and latterly Air Pacific) will have a virtual monopoly position on the following routes:

- Los Angeles** Monopoly on non-stop services - plus 3 services by operated by Air Pacific via Nadi. Just two competing Air Tahiti Nui flights via Papeete weekly
- Honolulu** Monopoly on non-stop services plus 3 services operated by Air Pacific and 1 competing flight operated by Polynesian Airlines via Samoa.
- Australia** Monopoly on Cairns, Melbourne and Perth direct flights plus virtual monopoly to many Australia points through Qantas network, plus Freedom Air services. Limited competition form Asian carriers as their services only top up long haul Asia services.
- South Pacific:**
  - Fiji** Monopoly with Qantas/Air Pacific partnership
  - Rarotonga** Existing monopoly position
  - Apia** Competing only with Polynesian Airlines, a code-share partner of Qantas
  - Noumea** Existing monopoly shared route with Air Calin
  - Norfolk Island** Existing monopoly position

History tells us that where Air New Zealand is operating in a monopoly or duopoly position the effective airfares for New Zealand travellers will be significantly higher than like destinations. For example fares to Melbourne (duopoly with Qantas) are 15% higher than those offered to Sydney, and 20% higher than Melbourne with multiple competitors.<sup>2</sup>

<sup>2</sup> See Table 1 – Current regular airfares from New Zealand as at 14 February 2003

## PART 1-b The Competitive Environment – International (Cont'd)

Already travellers to South Pacific destinations where there is limited duopoly competition pay fares approximately 40-75% higher per mile than equivalent fares to Australia. The extreme is Norfolk Island where fares are over \$1.20 per mile compared to an average around \$0.40c for Australia fares.<sup>3</sup>

There is also a 'lack of competition' effect on long-haul routes. Table 1 below details relevant fares per mile currently charged by Air New Zealand. It is interesting to note that Air New Zealand is never cheapest in any market where there is multiple carrier competition, but in those markets, its fares are always cheaper than for destinations where it is the monopoly carrier or faces limited competition.

While it is accepted that longer flights bring down the cost per mile of flying we think it is significant to note that Hawaii is the most expensive route by some margin – a route with little practical competition. For Japan and Taiwan where routes are code-shared with Japan Airlines and EVA respectively, the fares are also higher.

From past experience we believe if Air New Zealand, Qantas and Air Pacific are able to exercise an effective monopoly control, that in real terms, airfares for New Zealanders can be expected to rise by margins much higher than the 3-4% estimated by the applicants. We believe these related increases will be more than 10% over time.

The major benefit to member airlines of the merger will be the ability to reduce costs, with the biggest savings coming from the ability to streamline services and reduce the number of flights and the consequent reduction in seat supply.

Twenty years experience in this industry tells us that airlines seriously manipulate the supply of seats in cheaper price ranges, much more now with the improvement in their IT systems. By doing this they can still advertise, quite legally, cheaper fares with very limited capacity, while cranking up the average fares paid by travellers. An example of this is changes to fare rules in the Trans-Tasman market over the last few years forcing business travellers to pay fares approaching double the advertised excursion fares.

**Taking the reduced supply, along with the hidden ability of airlines to crank up average fares by manipulating seat availability we believe that effective airfare increases will be between 15-20% within three years of the merger, without taking into account any increases due to external factors such as fuel, exchange rates etc.**

**New Zealanders will therefore need to be prepared for airfare increases of up to 20%-25% over three years, particularly on short haul routes, unless significant new airlines enter the market**

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<sup>3</sup> See Table 1 – Current regular airfares from New Zealand as at 14 February 2003

## **PART 1-b            The Competitive Environment – International (Cont'd)**

### **Recommendations:**

**We believe that the proposed merger should not be approved in its current form.**

**Approval for any other alliance between these airlines needs to have strict conditions attached, until significant new entrants offer services in a market.**

**We suggest formation of an independent authority (funded by these airlines) for:**

- **Control on flight schedules – numbers of flights and the number of seats.**
- **Control and/or strict monitoring of advertised low fare availability.**
- **Control on fares - Increases over current levels should only be allowed for external or real internal cost increases.**
- **Monitoring undertakings given by the airlines to allow ease of entry for new competitors.**

## PART 2 National Interest

As outlined above we do not believe that New Zealand's national interest is served by having its citizens under the influence of a single dominant airline, with consequent increases in airfares, and likely reductions in services.

The applicants have acknowledged that the proposal will be anti-competitive, hence their application for an exemption under the commerce act. They support this application by appealing that the proposal is in the national interest, particularly pushing increased employment and attraction of increased tourist numbers.

Calculations of increased tourist numbers are in reality expensive guesswork in a fragile world and the resultant increase predicted is negligible compared to the current tourist arrival numbers and growth rates achieved in recent years.

Employment growth predictions are based largely around increased heavy engineering presence by Air New Zealand servicing Qantas aircraft. It is acknowledged that Qantas do need a third heavy engineering base for their existing fleet. The high capital cost of building a third base in Australia compared to expansion of a combined New Zealand base is one major attractions of the merger for Qantas.

We believe that Air New Zealand could successfully enter a commercial contract with Qantas for heavy engineering without a full merger, or merge its ANNZES company with Qantas engineering, (as was done previously with Ansett Australia) achieving rationalisation of engineering services and consequent savings, while maintaining full competition in the air.

We do not accept that tourism marketing of New Zealand cannot be achieved just as effectively with Air New Zealand as a stand alone airline. Tourism marketing shouldn't be too dependent on airline input anyway. A more innovative and clever approach may be required, rather than just large dollar input, but that is already the New Zealand way.

Arguments by Air New Zealand that they simply cannot survive without a 'big brother' Qantas, are to us defeatist, and to hear them from its CEO are surprising. Imagine Team NZ deciding it's all too expensive, too technical and just too hard to defend the America's Cup, This is simply not the New Zealand way.

Problems experienced by the world's airlines appear to be worst for the major operators – proof that big is not better?

We are yet to be convinced that Air New Zealand as a niche Pacific Rim carrier cannot survive and prosper. The big brother family support can surely be achieved through its existing membership of the Star Alliance.

Joint marketing including frequent flyer schemes, schedule co-operation, code-share services, shared ground facilities etc are the major benefits espoused by both the Star Alliance and OneWorld.

**Recommendation: It seems that Air New Zealand have not in fact fully explored real alternatives to the Qantas merger proposal. We would expect the Commerce Commission to ask to see proof of these studies, to examine them and in fact agree with the results before allowing this proposal to pass.**

### **PART 3      Travel Agents – Industry Sector under threat**

The on going relationship difficulties between travel agents and Air New Zealand have been very publicly aired in the past 12 months, particularly with Air NZ's decision to stop paying commission for domestic air travel.

We are not aware of any travel agent in New Zealand that believes a revenue structure based on commission is the only route, nor any that do not accept changes may be required to the very structure of our industry.

The main industry body TAANZ has offered on many occasions to meet Air New Zealand and other airlines to explore these issues.

Instead, in 2002 Air New Zealand using the excuse of its near collapse decided its way was the only right way and refused to enter any meaningful dialogue.

While Air New Zealand sold the changes as a way of bringing fares down for the consumer, the commencement (and general acceptance by the public) of booking/service fees has merely moved the expense from the airline to the consumer.

Many in the industry have accepted this fait accompli, moved on and developed new revenue streams with clients. Many in the agency sector were re-assured by the only major competitor Qantas publicly stating on a number of occasions that they had no intention of changing the commission structure.

The travel agency sector has so far survived the Air New Zealand domestic commission cuts. Any move however, to broadly slash commissions on the major Trans-Tasman, or long-haul markets would seriously undermine the long-term sustainability of the sector, also having a negative effect on employment.

In short the commissions currently paid to agents could not be replaced in the short term by booking, service or itinerary planning fees to the same level. Not only will the consumer be fobbed off with additional expense but we expect that the physical number of travel agents surviving will severely limit service and choice for the consumer.

Regardless Air New Zealand seem intent on pushing this strategy.

A merged Air New Zealand/Qantas, managed here by Air New Zealand, will mean that Qantas could back away from its current commitments to New Zealand agents by saying "Sorry mate, but New Zealand is run by Air New Zealand, and it's their decision." It also allows them to still honour the same commitment in Australia realising such changes there would be suicidal.

**Recommendation: If the proposed merger is to proceed in its current form, or in part, the Commerce Commission must add a condition covering travel agent remuneration, commission or otherwise to ensure the survival of travel agents, at least until a new substantial competitor is active in the New Zealand Market.**

**The industry is happy to discuss change and work with the airlines for a sound long-term working relationship, so these conditions can be for the short to medium term if necessary.**



**Appendix – Table 1 Competitive Effect of Airfares**

		Current Fare	Distance (miles)	Cents Per Mile (\$)	Non-stop Competitors	One Stop Competitors
Sydney	Air NZ Best - QF	549 499	1356 1356	0.405 0.368	QF TG AR PH	N/a
Melbourne	Air NZ Best	689 689	1638 1638	0.421 0.421	QF	
Brisbane	Air NZ Best - GA	539 499	1427 1427	0.378 0.350	QF TG MH	
Cairns	Air NZ Best	899 899	2249 2249	0.400 0.400	-	QF
Perth	Air NZ Best	1119 1199	3317 3317	0.337 0.361	-	QF
Apia	Air NZ Best - QF	1129 1075	1801 1801	0.627 0.597	PH	
Nadi	Air NZ Best - KE	935 749	1341 1341	0.697 0.559	FJ KE	
Norfolk Is	Air NZ Best	829 829	679 679	1.221 1.221	-	
Noumea	Air NZ Best - SB	1027 715	1145 1145	0.897 0.624	SB*	
Nuku'Alofa	Air NZ Best - WR	1059 850	1169 1169	0.906 0.727	WR	
Papeete	Air NZ Best - QF	1049 1035	2544 2544	0.412 0.407	QF TN	
Rarotonga	Air NZ Best	1154 1154	1874 1874	0.616 0.616	-	
Singapore	Air NZ Best - GA	1529 1459	5227 5227	0.293 0.279	SQ	QF MH TG CX GA
Hong Kong	Air NZ Best - MH	1749 1549	5699 5699	0.307 0.272	CX	QF SQ MH TG GA
Taipei	Air NZ Best - MH	1749 1549	5519 5519	0.317 0.281		QF SQ MH TG CX GA
Tokyo	Air NZ Best - JL	1749 1499	5493 5493	0.318 0.273	JL*	QF SQ MH TG CX
Honolulu	Air NZ Best - FJ	1549 1469	4406 4406	0.352 0.333	-	QF
Los Angeles	Air NZ Best - TN	2049 1599	6522 6522	0.314 0.245	QF UA	FJ TN
Vancouver	Air NZ Best - AC	2149 2115	7112 7112	0.302 0.297	N/a	AC QF UA
London	Air NZ Best - TG	2549 2099	11964 11964	0.213 0.175	N/a	QF SQ MH TG CX UA JL

Based on normal retail selling level of current airfares, as at 14 February 2003. Sale priced or short duration fares excluded.

Source: Bon Voyage Cruises & Travel supplier databases