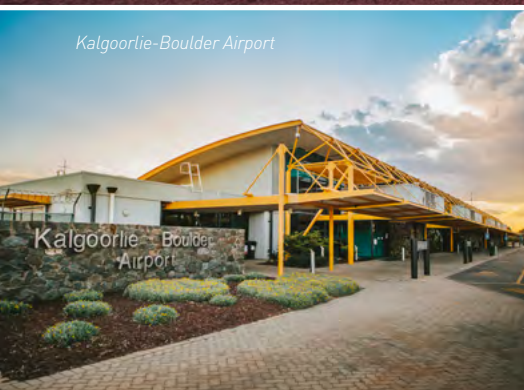


Tourism Council WA **Policy Paper**

Submission to the Inquiry into **Regional Airfares in Western Australia**



East Kimberley Regional Airport



Kalgoorlie-Boulder Airport



Banana Plantation Tour, Carnarvon



Geraldton Airport

Mimbi Caves near Fitzroy Crossing

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Glossary & Explanation of Terms

Airline Marketing Partnerships means a funding partnership between state government and an airline to invest in promoting a destination and a direct airline service to a market with a direct route to the destination. State funding is not given to the airline but invested in marketing by the state in return for new services, discounts, longer seasons or cooperative marketing funding from the airline.

Business Events means conferences, conventions, exhibitions, trade shows and incentives. Business events attract high-yield delegates to the destination at the time of the event and for pre and post-event touring.

Chartering means hiring an aircraft. Businesses may charter an aircraft for its own passengers on non-RPT routes. Destinations, e.g. local and state government, may charter a service available to the public for specific purposes or to assist establish an RPT route.

Contracted Product means accommodation, tours and other product which enter into a contract enabling an intermediary such as a Wholesaler, Travel Agent or OTA to sell the product in return for a commission. Typically requires digital systems to enable product to upload available inventory (seats, rooms and tickets) and prices.

Free & Independent Traveller (FIT) means visitors who book and arrange their own travel and tourism product on the open market i.e. not packaged tours or corporate contracts.

Global Distribution System (GDS) means the digital system into which multiple airlines place seats and airfares to be accessed by multiple travel agents and OTAs.

Online Travel Agent (OTA) means intermediaries such as Expedia which sell airline seats from the GDS, and contracted tourism product e.g. accommodation, to the FIT market in return for a commission.

Regular Passenger Transport (RPT) means regular services with seats available to the public rather than services where the entire aircraft is chartered by a single customer.

Royalties For Regions (R4R) means funding for regional development from the Royalties For Regions program, rather than funding from consolidated revenue for state development.

Subsidy means state government directly funding an airline in order to maintain services and/or reduce airfares.

Tourism Events means sporting, cultural and other festivals and events funded by the State Government to bring overnight international and interstate spectators or participants at the time of the event and for pre and post-event touring.

Underwriting means a destination, e.g. local and state government, guaranteeing an airline minimum load factor or revenue in return for providing a service available to the public. Airlines only receive funding if the service fails to reach the minimum load factor or revenue. Typically used to reduce the risk to an airline for establishing a new route.

Wholesalers means intermediaries who bring together multiple discounted contracted products (airfares, rooms and tourism product) to be sold as a package.

Coral Bay

1. Introduction

1.1 Western Australian Tourism

Each year Western Australia hosts 10,440,000 intrastate, interstate and international visitors travelling overnight across the State.¹ The vast majority of visitors visit Perth and more than half also visit regional WA. These visitors include leisure visitors such as holiday makers and those visiting friends and relatives, business travellers and other visitors such as short-term students.

The expenditure of visitors in Western Australia is a significant component of the State economy. In 2015-16 WA tourism generated:²

- \$15.4 billion in tourism consumption;
- \$3.2 billion in export earnings;
- \$11.8 billion in Gross State Product (\$6.0 billion direct GSP & \$5.8 billion indirect GSP); and
- 109,000 jobs (72,000 direct jobs and 37,000 indirect jobs).

1.2 Tourism Council WA

Tourism Council WA (TCWA) is the peak body representing tourism regions, industry associations and businesses in Western Australia. The Council promotes the value of tourism, facilitates sustainable tourism development and advocates industry policy on behalf of members.

Tourism Council WA represents more than 1,300 public and private sector members in aviation, accommodation, venues, hospitality, tours, attractions, events and regional tourism.

1.3 Submission to the Inquiry into regional airfares in Western Australia

Aviation is a critical component of the tourism industry, particularly in a state as large and remote as Western Australia. Due to its importance to the industry, Tourism Council WA has cultivated a thorough understanding of aviation, from both a market and public policy perspective, and appreciates the opportunity to make this submission to the *Inquiry into regional airfares in Western Australia*.

To assist the inquiry, Tourism Council WA undertook a survey of regional tourism operators to assess the impacts of airfares and identify actions which may address airfares. The Council also analysed current visitor data to assess the factors contributing to regional airfares and quantify the economic impact of airfares on regional leisure tourism.

This submission:

- Presents feedback from the tourism industry on the impact of regional airfares;
- Analyses the specific demand and supply factors affecting regional aviation and airfares in WA;
- Analyses the economic impact of airfares on regional tourism economic value and jobs; and
- Recommends actions that the tourism industry, and State and local governments, can take to reduce airfares and drive regional economic activity and jobs.

¹ Tourism Research Australia, International Visitor Survey and National Visitor Survey, YE March 2017

² Tourism Research Australia, State Tourism Satellite Accounts 2015-16, June 2017

Image courtesy Tourism Western Australia.



2. Tourism Industry Feedback

Tourism Council WA surveyed regional tourism businesses regarding their customers' feedback on regional aviation. There were 215 responses to the survey, the largest response Tourism Council WA has ever received from regional tourism businesses.

2.1 Regional Tourism Responses

The responses were from across the tourism industry including: accommodation (28%), tours & transport (26%), attractions & retail (13%), visitor centres (8%), caravan & camping operators (8%) and others.

Responses were received from all tourism regions and some respondents operated businesses in multiple regions. The largest response was from Australia's North West (58%), followed by Australia's South West (30%), Australia's Coral Coast (18%) and Australia's Golden Outback (9%).

The top five airports respondents nominated as the nearest airport to their tourism business were: Broome International (33%), Busselton-Margaret River (19%), Kununurra (16%), Albany (10%) and Geraldton (8%). Responses were received regarding more than seventeen airports.

2.2 Key Feedback

The overwhelming view of tourism businesses is that WA regional destinations are being priced out of the tourism market by airfares which are unacceptable to customers, particularly compared with the east coast and international destinations with which WA must compete.

Tourism businesses believe they are losing significant business as a result of these regional airfares. While this feedback was consistent across regional WA, the concern with airfares is most acute in Broome and Australia's North West.

2.3 Tourism Customer Satisfaction

On average, tourism businesses rated their customers' satisfaction with air services to their regional destination at just 30%. Regional tourism businesses identified the following feedback from their customers regarding their regional aviation service:

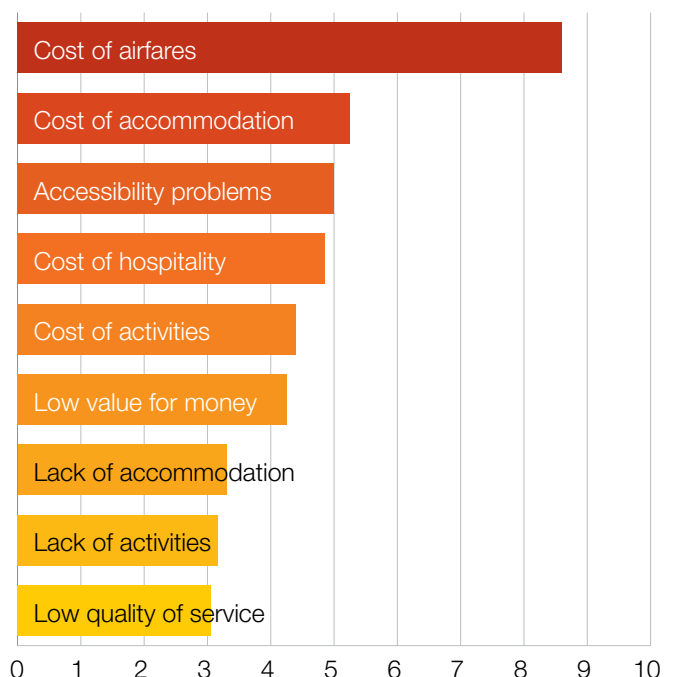
- Flights are too expensive or too expensive compared with other destinations (85%)
- Limited selection of airlines (59%)
- Flights are not frequent enough (54%)
- The schedule of flights is not visitor friendly (48%)
- Service offered not to an acceptable standard (38%)

The cost of airfares was clearly the primary concern of tourism businesses' customers. Based on customer feedback, tourism businesses reported that if flights were more affordable:

- Customers would return more often (81%)
- Customers would have travelled by air rather than by driving (69%)
- Customers would stay longer in the destination (64%)

2.4 Significance of Regional Airfares

Regional tourism businesses were asked to rate the barriers to first time or repeat visitation to their region. Barriers assessed ranged from cost of accommodation to lack of activities and things to do. The barriers were rated on a scale of 1 to 10. The cost of airfares was rated the most significant barrier.





Whale watching in Flinders Bay near Augusta



Busselton-Margaret River Regional Airport



REGAIR Submission 86
Rec'd 31 July 2017

Wills Domain, Yallingup

2.5 Tourism Industry Proposals

Respondents were asked for ideas and suggestions on how tourism and airlines can work together to make regional destinations more affordable and accessible. A content analysis of responses identified the following common suggestions.

- Develop and promote leisure tourism packages including discount airfares and tourism product (30%)
- Develop direct international and interstate regional routes by chartering, subsidy or marketing (10%)
- Public investment in marketing existing regional routes in return for discount airfares (10%)
- Enhanced marketing of regional destinations (8%)
- Increased airline competition (6%)
- Enhanced car hire services and reduced fees for non-return drop offs (4%)
- Enhance the frequency and scheduling of services (4%)
- Encourage airlines to provide discounts for locals or last minute empty seats (2%)
- Ensuring regional airlines are on the GDS (2%)
- Government subsidy to reduce airfares on existing flights (1%)
- Developing airports to expand capacity (1%)
- Reduce airport fees (1%)
- Cross subsidise routes across a regional network (1%)
- Total deregulation of all regional routes (1%)

2.6 Discounting Airfares

Tourism businesses identified the cost of airfares as the single greatest barrier to first time and repeat visitation to their destination. Tourism businesses were asked to identify the minimum discount needed to increase visitors travelling by air to the destination.

Tourism Business	Minimum Airfare Discount Needed
9% of businesses	Minimum discount 0%-15%
42% of businesses	Minimum discount 20%-30%
49% of businesses	Minimum discount 35%-40%

Tourism businesses were asked to identify what increase in visitors to their regional business they believe would result from the minimum discount in airfares.

Minimum Airfare Discount Needed	Estimated Increase		
	Inter-national	Inter-state	Intra-state
Minimum discount 0%-15%	25%	32%	30%
Minimum discount 20%-30%	31%	48%	54%
Minimum discount 35%-40%	41%	54%	62%

2.7 Discounting Tourism Product

Respondents were asked if they were prepared to match airline discounts with similar discounts for accommodation, attractions and other tourism product.

More than 60% of tourism operators were prepared to match airlines with a similar discount. However, approximately half of respondents advised they did not have the contracted product or distribution mechanisms in place to be able to include their discounted tourism product in a package with discount airfares.

Minimum Airfare Discount Needed	Match Discount	Able to Package
Minimum discount 0%-15%	71%	36%
Minimum discount 20%-30%	60%	50%
Minimum discount 35%-40%	60%	55%
Average	61%	51%



3. Regional Aviation Demand

There is little direct demand for regional aviation services. Demand for air travel is a derivative of the demand to visit a regional destination. Therefore, the demand for air travel depends greatly on the purpose of travel to a regional destination, whether there is a substitute mode of transport to the destination, and whether the regional destination can be substituted by an alternative destination.

3.1 Current Demand by Market and Purpose³

Market	Share %
Regional Residents	17%
Intrastate	50%
Interstate	26%
International	7%
Total	100%

Regional air routes serve both visitors to regional WA (83%) and regional residents travelling to Perth and beyond (17%).

Intrastate visitors dominate visitation to regional WA by air travel, followed by interstate and international.

Purpose (excl FIFO)	Share %
Leisure	41%
Business	56%
Other	3%
Total	100%

Business and FIFO passengers dominate regional WA aviation routes, accounting for 73% of visitors to regional destinations travelling by air.

Even when FIFO passengers are excluded, business still dominates as the primary purpose of air travel to regional destinations in WA.

Purpose (excl FIFO)	Air Travel	Other Travel
Leisure	8%	92%
Business	34%	66%
Other	12%	88%
Average	14%	86%

Leisure visitors to regional WA significantly outnumber business travellers. For every one business visitor there are 3.5 leisure visitors to regional WA. However, business visitors (34%) are far more likely than leisure visitors (8%) to travel by air than by other modes of transport such as driving.

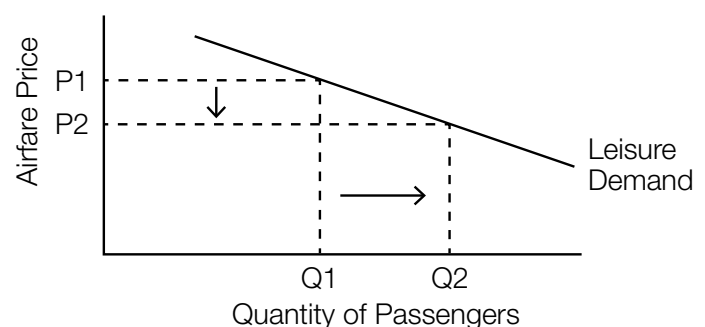
Intrastate business visitors dominate travel on Western Australia's regional aviation routes compared with regional residents or intrastate, interstate or international leisure visitors. This profile of demand for regional aviation fundamentally effects regional airfares.

3.2 Leisure Tourism Demand

Air travel by leisure visitors (including holiday makers and visiting friends & relatives) to regional destinations is relatively price-sensitive. This is because leisure travel is highly discretionary consumer spending. Leisure visitors can easily substitute a regional destination with an alternate leisure destination (e.g. Bali) or choose not to travel at all.

The demand for regional air services by leisure visitors is elastic i.e. a small change in price will have a relatively large impact on the number of leisure air travellers.

A small decrease in airfare price from P1 to P2 will result in a large increase in the quantity of leisure passengers from Q1 to Q2. Equally, a small increase in price results in a large decrease in passengers.



³ Tourism Research Australia, International Visitor Survey and National Visitor Survey, YE March 2017



East Kimberley Regional Airport



Shopping for Argyle Diamonds in Kunming

REGAIR Submission 86
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In regional WA, leisure tourism demand is not consistent throughout the year. Leisure demand for regional destinations such as Broome is highly seasonal and leisure demand also peaks with school and public holidays. The quantity of leisure demand and the price sensitivity of that demand changes throughout the year.

In Australia and across the world leisure tourism makes up the greatest share of visitor markets. This means most aviation destinations are price sensitive and airfares reflect this. Consumer expectations of the price of airfares are largely set by prices that consumers see for leisure destinations. Consumers are very aware of these price points as they actively research leisure tourism and there is extensive international and interstate destination and tourism product marketing aimed at Western Australian consumers.

3.3 Regional Residents

As well as inbound intrastate, interstate and international visitors to regional WA, aviation routes also provide an outbound service for regional residents travelling to Perth and beyond.

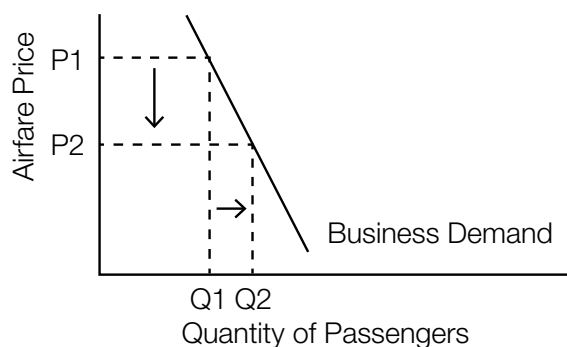
These regional travellers are predominantly leisure rather than business travellers and their price expectations are formed by airfares to leisure destinations with which they are very familiar. However, while regional residents are very price-sensitive their demand is not the same as leisure traveller demand because of limited population size.

The market for inbound visitors to regional WA is potentially unlimited, while the market for outbound is highly limited by the small populations of regional WA towns. For regional residents a small decrease in the price of airfares may increase the demand from individuals, but the number of residents is so low that the increase in passengers is relatively small. So while individual residents are price-sensitive the demand from regional residents is inelastic as it is confined by small population bases.

3.4 Business and Government Demand

Air travel by business and government visitors to regional destinations is relatively insensitive to price, because the demand is less discretionary. Unless a teleconference can replace the business travel, there is limited ability to forego the business travel or to select a substitute destination.

Decreasing the price of travel does not increase the demand to attend more business meetings in the regional destination. Similarly, essential government services are non-discretionary and therefore less price-sensitive. The demand for regional air services by business and government is inelastic i.e. a large change in price will have a relatively small impact on the number of leisure air travellers.



A large decrease in airfare price from P1 to P2 will only result in a small increase in the quantity of business and government passengers from Q1 to Q2. Equally, a large increase in price results only in a small decrease in passengers.

Unlike most aviation destinations in Australia, business and government travel is a much higher share of visitation to Western Australian regional destinations.



3.5 Event Demand

Business and tourism events drive demand for air travel to regional destinations. Event-driven demand goes through two phases. When the destination for an event is still being selected there are many substitute destinations and the selection is price-sensitive at that point in time. Demand for associated air travel is elastic.

Once an event destination is finalised, demand for air travel by attendees to the event becomes less elastic because the event attendee cannot select an alternate destination. Demand for associated air travel becomes inelastic.

3.6 Substitute Travel

While competition between airlines on regional WA routes is highly limited, alternate transport can provide a competitive substitute. Land transport by private vehicle is the most common and effective alternative transport for regional travel. Effective alternative transport creates greater elasticity in aviation demand for price-sensitive visitors. As airfares rise, demand decreases as visitors elect to drive rather than fly.

Driving long distances is time consuming compared with air travel. As the time cost increases, distance driving becomes less of an effective alternative and aviation demand becomes less elastic. This means short-haul routes such as Perth to Busselton will be more price-sensitive than long-haul routes such as Perth to Broome.

Time costs are different for each visitor type. Business travellers are more time sensitive and are therefore less price-sensitive to airfares as driving is an expensive substitute. Leisure travellers with lower time costs such as grey nomads and backpackers are more price-sensitive to airfares as driving is a competitive substitute.

3.7 Distribution

Airlines can increase demand by making airfares internationally accessible and bookable online through OTAs and other channels. Airlines distribute their airfares and discount through wholesalers via the GDS.

Regional airlines which are not on the GDS reduce their potential demand and are not able to readily discount, package and promote their aviation route. Passengers must go to the airline's website to book a ticket and will not find the regional aviation service on websites such as Webjet and Expedia.

3.8 Overall Demand for Regional Air Routes

Overall, WA regional air routes have far more inelastic demand compared with other routes in Australia, including regional routes in other states. This is because of:

- The relatively low proportion of price-sensitive leisure travellers to regional WA;
- The relatively seasonal nature of leisure tourism to regional WA;
- The relatively high proportion of business and government travel to regional WA, particularly driven by the resources sector;
- The relatively smaller regional WA population bases supporting each regional aviation route; and
- The relatively longer distances over which driving does not provide a competitive substitute.

For these reasons, regional WA routes have relatively less elastic demand than other Australian regional routes. The elasticity of demand varies significantly from route to route and over time. A Broome-Melbourne service in peak tourism season is predominantly a leisure route, while Perth-Broome in the off season is predominantly a service for business and regional residents.



Valley of the Giants, Tree Top Walk

4. Regional Demand on Airfares

Where airlines make tickets available on the open market directly through their airline websites or via OTAs through the GDS, they essentially offer the same airfares to all potential visitors regardless of their purpose of travel and price sensitivity.

In this open market, higher airfares may decrease leisure travel demand and generate a revenue loss. However, higher airfares would have a minimal impact on the demand from business and other travellers and would therefore generate revenue gain.

Where the revenue gain from business and other travellers exceeds the revenue loss from leisure travellers, the higher price will prevail.

An airline operating in relatively price inelastic regional WA is less likely to discount prices because it will result in a net revenue loss, even if they attract more passengers.

4.1 Online Airfare Distribution

Airlines can increase demand by making airfares internationally accessible and bookable online by the FIT market via OTAs and other channels. Airlines distribute their airfares and discount through wholesalers via the GDS.

Regional airlines which are not on the GDS reduce their potential demand and are not able to readily discount, package and promote their aviation route. Passengers must go to the airline's website to book a ticket and will not find the regional aviation service on websites such as Webjet and Expedia. This limits demand.

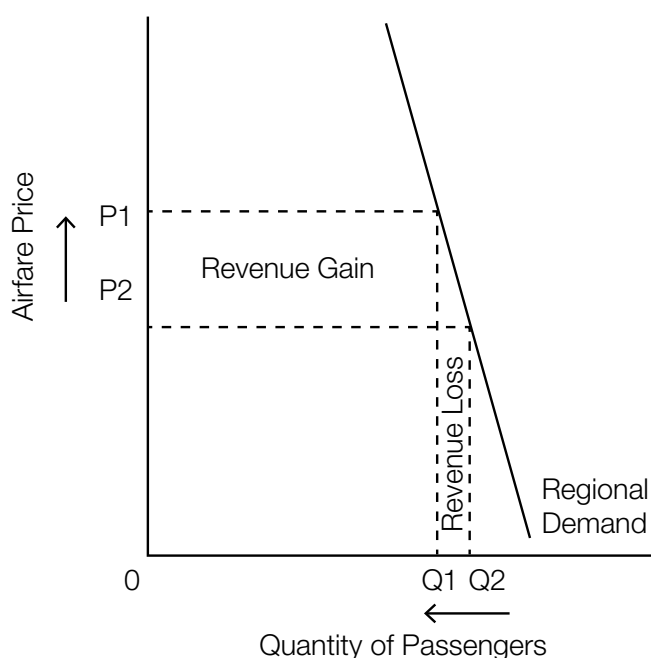
4.2 Dynamic Pricing

Airfares are dynamic and change constantly with demand through the GDS. This is an automated and rapid process. When booking on OTAs, travellers typically have a maximum booking timeframe of 30 minutes during which fares remain constant. Dynamic pricing automatically lowers prices when there is little demand (i.e. few costumers searching or booking flights) and increases prices when demand increases.

Typically, less time sensitive leisure visitors are more likely to book early and will be offered lower fares, while time sensitive business travellers book later so the airfares are increased closer to the flight. Airlines' dynamic pricing algorithms are highly sophisticated and automatically account for previous demand history, seasonality, time before flights, seats remaining, competitor pricing, number of consumers browsing, etc.

The purpose of dynamic pricing is to maximise revenue for the airline by constantly adjusting prices on the open market as demand changes. This enables airlines to offer lower prices to price-sensitive travellers, and higher prices to less price-sensitive travellers, at different times in the same open market.

Dynamic pricing is so significant that it becomes increasingly meaningless to describe or attribute "average" airfares for a given regional route. For every high fare on a route, a lower fare will be found on that route at a different time. The "average" fare may be a price that is rarely or never seen by





Yardie Creek, Cape Range National Park



Monkey Mia Dolphins

travellers. There is not a normal or average airfare, there is only the airfare available at that point in time.

4.3 Fare Types

On the same flight and in the same open market airlines offer different airfares to different travellers. Airlines offer business class and economy fares aimed at the different price sensitivities of the business and leisure markets. Airlines also offer flexible fares at high prices and discount inflexible fares for the same seat. These fares are aimed at travellers with different price-flexibility sensitivities typically business vs. leisure travellers.

4.4 Distributing Discount Airfares to Select Markets

In an open market with airfares available to the general public an airline cannot offer a lower price to the price-sensitive leisure traveller without offering the same low airfare to the business traveller, resulting in a net revenue loss.

Alternatively airlines and destinations can engage in marketing strategies to distribute airfares to different markets at different prices and different times.

4.5 Targeted Discounting to Leisure Visitors and Regional Residents

Airlines can also provide discounts targeted to particular markets that are not available on the open market for the FIT market to book. One such discount is for price-sensitive local residents. Airlines can offer a discount based on location e.g. local postcode, so long as there is a means to distribute the discount airfare only to locals and thus prevent business and other less price-sensitive travellers from accessing the lower airfare. This can be achieved through a variety of means.

This strategy enables airlines to discount for locals without taking a revenue loss for offering the lower price to business travellers. However, where load factors are high, airlines will not discount as an increase in locals would displace higher yield business travellers on full flights.

4.6 Leisure Tourism Packaging

Airlines will also significantly discount airfares which are included in a leisure tourism package. By including the airfare in the package only the package price is known. The discounted airfare component is not listed or able to be booked separately from the package.

Packages are developed that appeal to leisure visitors not business travellers, for example packages can include resorts, tours and leisure attractions. Leisure packages will also focus on weekends and/or have a minimum length of stay that does not suit business travellers. Leisure tourism packages enable airlines to regularly discount airfares up to 30%, without taking a revenue loss for offering the lower price to business travellers.

Packages can also change the demand for the regional destination, as well as demand for airfares, to further increase leisure travel. This is because packages can include discounts from accommodation, tours and attractions as well as discount airfares. Each product component can discount their price because the lower price is not available on the open market, only the total package price.

The cumulative value of multiple product discounts can create a leisure package of significant value. This will drive additional demand for the destination and each product which is included in the package i.e. the hotelier gets the advantage of the discount airfares and the airline gets an advantage from discounted room rates. Regional airports can contribute to leisure packages by discounting landing fees. Regional destinations can also contribute through underpinning package development and marketing.

Leisure tourism packages are highly effective means of reducing airfares and other destination costs while significantly increasing demand for those products and the regional destination. Leisure packaging does have additional costs to airlines and tourism product such as commissions to wholesalers and the collective costs of developing, contracting and advertising the package to target markets.



As always, airlines and other operators will discount in packages only where business travel can be excluded and when the load factors or room occupancy is low enough that the package visitors do not displace higher yield full price visitors.

Of the regional tourism operators surveyed, 61% responded that they would be prepared to discount their tourism product in a tourism package with discounted airfares. However only 51% of those operators were able to be included in packages with commissionable product contracted with wholesalers.⁴

Western Australian tourism does not leverage packaging to the same extent as other states. For example, only 8% of international leisure visitors travelling to regional WA by aircraft arrived on a travel package while 69% of international leisure visitors travelling to regional QLD by aircraft arrived on a travel package.⁵

Leisure tourism packaging requires significant cooperation and effort to bring multiple parties together including airlines, airports, contracted products, destination marketing organisations and wholesalers. There is no organisation which is particularly funded or responsible to undertake this task at a regional destination level. Each of the parties must also be prepared to contribute financially through reduced prices, commissions and investing in marketing and promoting the packages. However, once packages are established they are a highly effective means of increasing visitation without reducing returns from the open FIT market.

Western Australian tourism needs to build capacity for online distribution and packaging. This is critical to developing regional leisure packages, Perth Stadium event packages and stopover packages for the London Perth direct flights. Tourism Council WA, with support from Tourism WA, is working with tourism businesses to assist them to become bookable online and become contracted product able to be distributed, packaged and sold internationally by Travel Agents, OTAs and Wholesalers (see Case Study 1 – Tourism BOOST).

⁴ Tourism Council WA Regional Member Survey – Inquiry into Regional Airfares July 2017

⁵ Tourism Research Australia International Visitor Survey and National Visitor Survey, YE March 2017

Case Study 1: Tourism BOOST Online & International Bookings

The Tourism Boost Online & International Bookings Program is a one-on-one mentoring program that assists tourism businesses to sell their product online and introduce new WA tourism product to international and domestic markets.

The program utilises a sophisticated online IT diagnostic and assessment tool that assists tourism businesses to develop commissionable and contracted product that can be included in tourism packages promoting their destination.

Mentoring assists tourism businesses to improve their marketing capability direct to consumers (B2C) and connects tourism product (the supplier) to the wider tourism industry as part of a complete tourism trade marketing strategy (B2B), allowing tourism businesses to reach interstate and international markets cost effectively.

Testimonial

“Through the Tourism Boost Mentoring Program, the National Anzac Centre (NAC) was able to develop a product and rate structure that resulted in being successfully contracted with a number of domestic and international travel wholesalers and included in their tourism packages promoting Albany. Our mentors provided invaluable industry knowledge that guided us through the distribution process and improved our visitor experience offering.”

Matthew Hammond,
National Anzac Centre Albany





Camel ride on Cable Beach, Broome

5. Regional Aviation Costs and Airline Supply

5.1 Airport Costs and Charges

Airport costs are passed on to airlines as various landing charges. Airlines pass their costs onto passengers through higher airfares. Airport costs include operational costs, security compliance costs and Airservices Australia charges.

Airports are capital intensive with relatively fixed operational costs regardless of the number of flights. In the long-term, capital upgrades increase these fixed costs but serve more passengers. In the short run, airport costs must be spread over the number of flights served. The more flights an airport services, the lower the costs per landing.

The costs of meeting security regulations are semi-fixed (case study 2) and must also be spread over landings i.e. the more flights, the lower the cost per flight. Airservices charges such as navigation and firefighting are variable and only applied per landing, therefore more landings does not decrease the price per landing.

Airlines charged these per landing costs must spread the costs over the number of passengers paying airfares. The larger the aircraft and the higher the load factor, the lower the cost per passenger airfare. Thus the impact of airport charges on airfares changes from route to route.

Routes with large aircraft and high load factors landing at airports serving multiple flights have low per passenger costs on that route. Conversely, routes with smaller planes and/or low load factors landing at airports with fixed costs spread over fewer flights will increase costs per passenger.

The overall impact of regional airport costs on regional airfares depends on the route, but TCWA estimates costs would range between \$40 and \$80 per one way passenger.

Investment in airport development which does not attract additional demand only serves to increase airfares per passenger to cover capital or maintenance costs. Public or private investment in airport development should follow

Images courtesy Shire of Wyndham-East Kimberley and Tourism Western Australia.

Case Study 2 – Compliance Cost of Aviation Security Regulation

Commonwealth regulations require airports to undertake passenger security screening for flights over 20 tonnes. The cost of passenger screening is passed on to airlines via airport charges and subsequently passed on by airlines to passengers via airfares.

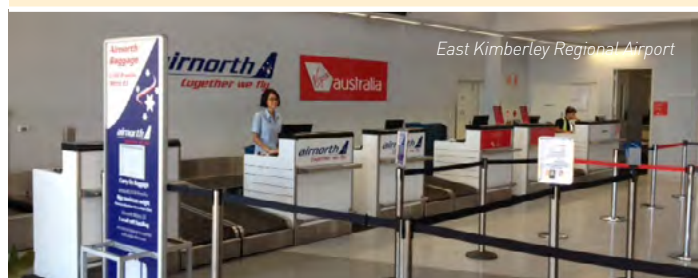
Passenger screening incurs fixed equipment, floor space and facilities costs. However, the primary cost is labour. There is typically a minimum fixed labour cost (i.e. minimum staff numbers for minimum hours) to operate passenger screening, irrespective of how many passengers are processed.

For a regional airport with minimal departures, the minimum labour cost may be spread over only one departing flight. That departing regional flight will typically have a small number of seats and would rarely be fully loaded. This means the fixed costs and minimum labour cost will be spread over a small number of passengers, leading to a high airfare.

The minimum cost of security screening per passenger airfare varies greatly between airports depending on fixed costs, minimum labour costs, flight schedule, aircraft size and load factor. TCWA understands that up to \$40 per airfare may be due to the costs of aviation security requirements at small airports such as Esperance.

REX airlines has entered the Perth-Albany-Esperance route using their 34 seat SAAB 340 aircraft. These aircraft do not require security screening under Commonwealth regulation. This has immediately reduced the per passenger cost of these flights which had been a significant component of the airfare.

Commonwealth regulations have little regard for the security risk of a route or the per passenger cost of compliance. Consequently, the current regime drives smaller aircraft with reduced supply and/or higher airfares on smaller regional routes lacking economies of scale.





Horizontal Waterfalls, Talbot Bay



East Kimberley Regional Airport

investment in driving demand which increases the number of passengers over which the costs are spread.

5.2 Regional Airports and Low-cost Carriers

There are currently no low-cost carriers on regional WA routes. One reason is that low-cost carriers typically seek minimal airport charges to underpin their low airfare model. Airports must still recover their costs but some airports secure significant revenue from passengers through retail and hospitality tenancies, car parking, rental car companies, etc.

Airports with significant passenger movements will reduce landing fees for low-cost carriers which will attract large volumes of passengers generating additional airport revenue. Gold Coast Airport is an example of this model. Regional airports in WA have minimal revenue streams from passengers to cover costs and are reliant on landing charges. This is a barrier to reducing up-front airfares and attracting low-cost carriers.

5.3 Airline Costs and Economies of Scale

Operational costs of airlines and individual routes are closely guarded commercial information and hence difficult to properly assess. However, there are clearly significant fixed costs compared with variable costs.

Public commentary on airfares often focuses on variable factors such as distance which makes “common sense” to the consumer when comparing the cost of a flight to regional WA to the cost of a flight to Asia. However, variable distance costs (staff, in-flight service and fuel) is a relatively minor consideration compared with fixed and opportunity costs for a route. Even expensive aviation fuel has a relatively significant spend in the take-off cost, rather than the subsequent cruising cost of distance.

While many factors influence the cost of operating a route, the most significant impact is economies of scale. From airport security costs to aircraft investment and maintenance costs, the larger the volume over which to spread costs, the lower the costs and airfares per passenger.

Low volumes lead to a lack of competition and poor economies of scale. This is the primary cause of high airfares in regional WA. Volume depends on the demand profile for each route. Demand from regional residents and business travellers is fundamentally limited by local population and business activity. Demand from leisure is potentially unlimited. Low-cost destinations and routes are those that attract large volumes of leisure visitors creating economies of scale and competition.

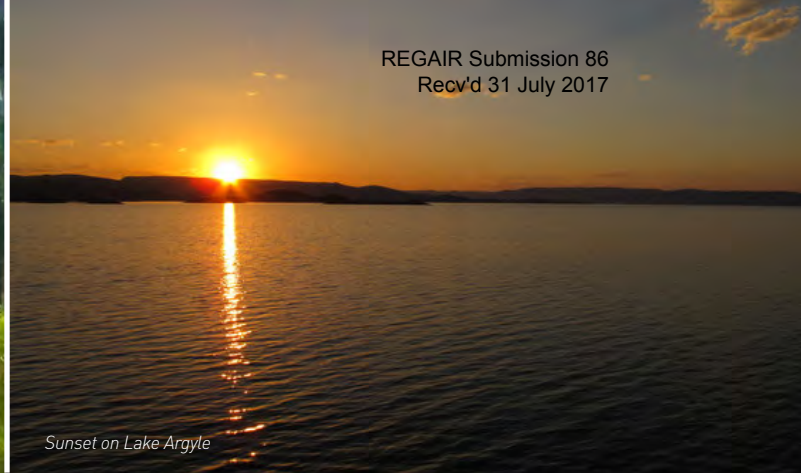
5.4 Opportunity Cost of Servicing Alternate Routes

A key consideration for an airline is the opportunity cost of deploying an aircraft on one route at the expense of a different route. There are short-term transaction costs for an airline to change schedules but in the medium term aircraft are highly mobile assets and can be transferred from one route to another.

If the revenue received by an airline for deploying an aircraft on a regional WA route is less than the revenue the aircraft would generate on a regional Queensland route then the airline will deploy the aircraft to Queensland. Deploying aircraft away from WA regional routes limits supply by reducing the number of services, size of aircraft and degree of competition. When supply is limited airfares increase.

The opportunity cost is particularly high for servicing seasonal regional WA routes. For example, additional services to Broome or Exmouth during peak season must cover their operational costs and the opportunity cost of being redeployed from other routes and any downtime before or after peak season.

The opportunity cost determines the fundamental viability of regional routes. Even if a regional WA route can cover its operational costs, the revenue may be so low compared with other routes that no airline will service the route.



Sunset on Lake Argyle

5.5 Aircraft Schedule, Size and Load Factors

The supply of aviation services on a regional aviation route depends on the schedule and number of flights, and the size and number of seats on that aircraft. This determines the maximum supply of seats in the short term. At a given level of demand, airlines set airfares to maximise revenue for the supply of seats available at the time. The percentage of seats filled at that airfare is the load factor.

The cost to an airline of providing a flight does not vary greatly with the number of passengers. Therefore low load factors (i.e. empty seats) represent significant profits foregone by an airline. Airlines will always seek to maximise load factors.

Airlines can increase load factors by increasing demand. When demand is elastic, airlines can reduce airfares to increase the load factor and overall revenue. When demand for a regional WA flight is inelastic, reducing the open market airfare may increase the load factor but reduce overall revenue. However, airlines can use targeted discounting and leisure tourism packages to increase the load factor without foregoing revenue from business travellers.

Alternatively, airlines can reduce load factors by reducing the supply of seats. This can be done by reducing the number of flights and reducing the size of the aircraft. For seasonal routes such as the East Coast to Broome service, load factors can be increased by reducing the length of season. This enables airlines to deploy aircraft to other routes with higher returns. Reducing the supply of seats increases airfares.

5.6 Fleet Investment Decisions

In the short run, airlines have a set fleet of aircraft number, types and seat capacity. Airlines deploy these flights to various routes to maximise returns. The fleets available at any given time provide the total potential supply of air services to regional WA.

Investment in new aircraft, and the retirement of existing aircraft, is one of the most important decisions airlines make. These investments determine the capacity available to an airline in the long-term. The investment decisions reflect the market strategy airlines are pursuing. These strategies reflect assessment and planning for the changing demand from destinations and an assessment of the competitive positioning with other airlines, particularly with other airlines' fleet investment and capacity decisions.

The cumulative impact of airlines' fleet investment decisions determines the total potential supply for regional WA air services. Decisions by major airlines to increase investment in wide-bodied aircraft and retire smaller aircraft from their fleet may result in these airlines exiting smaller regional WA routes in favour of larger leisure routes.

Qantas and Virgin invested heavily in wide-bodied aircraft in pursuit of greater domestic market share. The increased supply resulted in greater price competition for large interstate routes but had no impact on regional routes to which wide-bodied aircraft were not suited. Hence Perth-Sydney became relatively cheaper than Perth-Broome.

On the supply side, fleet investment decisions are the most significant long-term concern for regional airfares and services. As ageing regional fleets are replaced, investment in larger aircraft may result in some airlines exiting smaller regional routes. Other airlines may remain on regional WA routes but invest in smaller aircraft to increase load factors. Either of these decisions will decrease supply and increase airfares.

Tourism Council WA is highly concerned that long-term fleet investment decisions will reduce competition and the supply of regional aviation services. This will leave regional destinations locked into less services with higher airfares or locked out of air services altogether.



East Kimberley Regional Airport



Chamberlain River, El Questro Station

6. Airline Competition

6.1 Airline Competition

Aviation is normally a highly competitive industry. Airlines develop competitive strategies regarding pricing, scheduling and fleet investment to maximise market share and yield.

Airlines do not compete on price alone. Airlines invest in branding and product differentiation strategies to reduce price competition. For example, airlines with strong loyalty programs can offer higher airfares than their competitors because passengers prefer loyalty program points to lower airfares. Non-price competition has a notable impact on the relative pricing between airlines on regional routes such as Perth-Broome.

Airline competition increases the supply of air services and can reduce airfares depending on the degree of elasticity of demand. The extent and impact of competition depends on the demand profile and elasticity for the route to the destination.

6.2 Airline Competition on Leisure Routes and Low-Cost Carriers

Aviation routes with large potential leisure markets, economies of scale and elastic demand will attract multiple airlines, increase competition and lower airfares. This increases demand until an equilibrium is achieved between supply and demand. This market phenomena is the driving force behind the exponential growth of wide-bodied aircraft and particularly low-cost carriers.

This competition has a compounding effect. Airlines invest in more wide-bodied aircraft to increase or defend their share of the market. This increases the overall supply, decreases airfares and increases demand from highly price-sensitive leisure markets.

Leisure destinations served by these low-cost carriers become increasingly competitive compared with other destinations. This increases demand for the destination. With greater demand there is greater word-of-mouth and investment in marketing, to promote the destination. This

further increases demand which attracts further competition. This phenomena has fundamentally altered aviation globally by lowering prices and increasing the market for leisure visitors. Consumers' expectations of reasonable airfares has fundamentally changed with this phenomena.

6.3 Airline Competition on Regional Non-Leisure Routes

Regional routes dominated by a fixed demand from business travellers and regional residents do not attract competition because there is insufficient demand from these visitors to use the increased supply. Even if competition lowers airfares it will not increase the population of regional towns or the propensity to attend business meetings.

In these regional areas demand is limited and may not support two or more airlines. Even if the limited demand can support two or more airlines, price competition is limited because demand is relatively inelastic.

Since SkyWest was absorbed by Virgin, no regional WA route has attracted more than two airlines. Routes such as Perth-Broome have limited competition from the Qantas – Virgin duopoly. The Perth-Learmonth (Exmouth) route could not sustain competition and has reverted to a monopoly.

Qantas and Virgin have clearly exited routes such as Perth-Albany and given their fleet investment decisions they are unlikely to return at the current levels of demand. This leaves Skippers and new entrant REX airlines servicing the regional RPT routes that Qantas and Virgin won't operate on.

Where a route cannot sustain two airlines it is a natural monopoly. For an unregulated monopoly, competition only occurs if one airline is prepared to enter a route and engage in a price war until the existing airline exits the route. At that point, airfares return to the previous level set by inelastic demand and monopoly supply. This is an unlikely risk for a regional airline to take, particularly given the costs of deploying a limited fleet into a price war.



Kalgoorlie-Boulder Airport

A regulated route introduces periodic competition through a regular tender to operate the route. The tender process can lead to some regulation of prices but this remains limited due to inelastic demand and minimal entrants into the competitive tender process.

6.4 Airline Competition for Corporate Business

On regional WA RPT routes airlines may enter into corporate contracts with businesses providing discounted airfares in return for being the preferred or exclusive supplier on that route. This practice is common in WA with resource sector businesses on particular regional routes.

The main advantage for an airline is that the corporate contracts reduce or may even lock out the competition from other airlines on the route. In this way the businesses get the discount price value of the competition and other RPT passengers pay higher open market airfares with reduced competition.

6.5 Airline Competition for Regional Leisure Routes

Airline competition only works to lower price where the lower price increases demand from the unlimited market for leisure visitors. This generates enough additional revenue to sustain competition and downward pressure on prices.

In the long run the only way to attract sustained airline and price competition is to increase demand from price-sensitive leisure visitors to the extent that the revenue gained from additional travellers at lower prices outweighs the lost revenue from business travellers.

The potential demand by inbound leisure travellers is limited only by the size of the global market, unlike demand from regional residents and business which is limited by local population size and local business activity. Actual demand from leisure air travellers depends on the appeal of the destination and the value of airfares. Both must be enhanced for price competition to be sustained and grow.

6.6 Pathway to Lower Airfares

Fundamentally the demand profile for a regional WA destination must be altered from predominantly business to predominantly leisure, until the revenue gain from increased leisure visitors due to lower airfares exceeds the revenue lost from fixed number of business travellers paying less.

The path to increasing leisure air travel to regional destinations starts with enhanced promotion of those destinations capable of growing inbound leisure air travellers. This will increase overall demand. Enhanced regional destination promotion needs to be accompanied by specific marketing strategies for air travel to those destinations.

International and interstate demand for regional destinations is predominantly leisure demand. Direct international and interstate routes to regional destinations should be developed until sustainable competition is achieved. This growth can be achieved through chartering services, short-term subsidies, airline marketing campaigns, leisure tourism packages and discounting. These routes will be predominantly leisure routes attracting price-sensitive leisure visitors with lower prices on the open market.

Existing intrastate regional routes are predominantly business routes. On these routes discounting and leisure tourism packages should be used to distribute lower prices to leisure visitors to absorb empty seats and increase load factors. Higher load factors can lead to larger aircraft with greater capacity for discounting and leisure packaging for regional residents and leisure visitors through Perth Airport.

These two marketing strategies will increase leisure visitors to the regional destination. This increases word-of-mouth, and investment in marketing and destination development, to promote the destination. This makes the destination more competitive relative to other destinations further expanding demand.



Broome International Airport

Gantheaume Point, Broome

7. Economic Impact of Regional Airfares

Higher airfares reduce leisure visitors to regional destinations who would otherwise spend time and money in that destination. In a free market, the airfare may maximise the net revenue for airlines but result in sub-optimal revenue for the destination. On a \$500 return regional flight, a discount of 15% may cost an airline \$75 revenue but earn the regional destination \$1,000 from spending by an additional visitor.

Regional Airfares Reduction	Additional Spend	Additional Jobs
15% average discount	\$99.8M	440 FTE
30% average discount	\$151.9M	680 FTE
40% average discount	\$174.2M	770 FTE

Tourism Council WA has estimated the economic impact of reducing airfares on average of 15%, 30% and 40%.

In each scenario, the reduction in airfares results in significant additional economic activity and job creation in regional WA.

For example an average reduction in regional WA airfares of 30% would generate additional visitor spending of \$152 million in regional WA, which would generate 680 full time equivalent regional jobs.

Explanatory Notes

Leisure Visitors is the number of visitors to regional WA in the 12 months to March 2017 whose stopover reason was leisure (holiday makers and VFR) and who travelled to the regional stopover by aircraft.⁶

\$ Avg. Spend is the average expenditure per trip by leisure visitors to regional WA in the 12 months to March 2017 whose stopover reason was leisure (holiday makers and VFR).⁷

Visitor Increase is the estimated increase in leisure visitors to regional WA as a result of an average discount of 15%, 30% or 40% on regional airfares for leisure visitors.⁸

Additional Spend is the additional expenditure arising from the increase in leisure visitors to regional WA as a result of an average discount of 15%, 30% or 40% on regional airfares.⁹

Total Spend is the combined Additional Spend for the increase in Intrastate, Interstate and International leisure visitors to regional WA.

Additional FTE is the additional direct and indirect full time equivalent employment created by the total additional spend from regional leisure visitors.¹⁰

Economic Impact of Discounted Airfares for Regional Leisure Visitors

Market	Leisure Visitors	\$ Avg Spend	15% Avg. Regional Airfare Discount		30% Avg. Regional Airfare Discount		40% Avg. Regional Airfare Discount	
			Visitor Increase	Additional Spend	Visitors Increase	Additional Spend	Visitors Increase	Additional Spend
Intrastate	110,000	\$503	30%	\$16.6M	54%	\$29.9M	62%	\$34.3M
Interstate	173,000	\$1,318	32%	\$73.0M	48%	\$109.3M	54%	\$123.1M
International	36,000	\$1,132	25%	\$10.2M	31%	\$12.7M	41%	\$16.7M
Total Spend				\$99.8M		\$151.9M		\$174.1M
Additional FTE				440		680		770

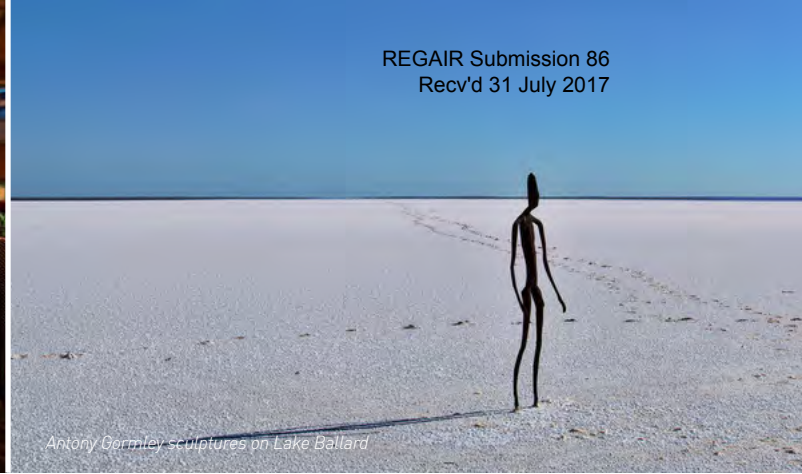
6 Data from Tourism Research Australia International Visitor Survey and National Visitor Survey, YE March 2017

7 Analysis by Tourism WA of data from the International Visitor Survey and National Visitor Survey, YE March 2017

8 Average estimate by tourism businesses responses in the Tourism Council WA Regional Member Survey – Inquiry into Regional Airfares July 2017

9 Calculation by Tourism Council WA (Leisure Visitors x Visitor Increase x \$ Avg Spend)

10 Analysis of data from the Tourism Research Australia State Tourism Satellite Account 2015-16



8. Public Policy Approach

8.1 Policy Rationale – Economic Development, Diversity and Jobs

Market failure in regional aviation exists because the benefits of reduced airfares are external to airlines. On a regional route with relatively inelastic demand, a reduction in airfares would result in a net revenue loss for the airline but a significant revenue gain for the regional destination through increased leisure visitors and expenditure.

State Government policy can stimulate lower cost air travel from the price-sensitive leisure markets to regional destinations. Because demand from leisure visitors is not capped by local population and local business activity, these policies will result in additional visitors. Additional visitors results in additional visitor spending diversifying the regional economy and creating jobs.

These policies would also generate benefits from economic diversity. As the leisure visitors to a regional destination expand, the town and airlines become less dependent on resource sector business to underpin the route. Over time, the demand profile for the destination will change and be relatively more price-sensitive, resulting in lower airfares driving further growth.

Alternatively, State Government policy may focus on attempting to reduce airfares for existing business travel or regional residents. While this policy would be beneficial to those individual travellers, it would not create economic outcomes for the State from additional travel, spending or economic activity, because demand from those travellers is capped.

8.2 Policy Approach

State Government policy initiatives have previously focused on addressing supply-side rather than demand-side issues. Policy initiatives such as the Regional Airport Development Scheme may enhance airport capacity but do not create additional demand to drive additional services, seats, competition or travellers.

Similarly, route regulation is necessary to maintain services on monopoly routes with limited demand, but the policy has no ability to attract additional demand which could ultimately end the need for regulation. Neither of these policies address the core issue of limited demand or are capable of driving economic growth and jobs.

Tourism Council WA contends that State Government focus on policy initiatives which stimulate demand rather than expanding capacity. In short, government should focus on route development rather than airport development.

A major advantage of this approach is that investment in route development and marketing requires considerably less government funding than investment in airport infrastructure. The ROI for this funding is also higher and more certain. Tourism Council WA contends that on established routes, the State Government should seek a minimum ROI of \$20 in additional visitor spending for every \$1 of R4R funding invested.

To apply this policy approach, the State Government should assess each individual destination and route and apply policy settings appropriate to the demand and supply profile for that route. The State Government should also prioritise any expenditure based on ROI from additional traveller spend.



Lucky Bay, Cape Le Grand National Park



Frenchman's Peak, Cape Le Grand National Park

9. Recommended Actions

9.1 Regional Airport Security

The State Government should advocate that the Commonwealth apply a risk management approach to airport security regulation and take responsibility for the impact of Commonwealth regulation on regional airfares.

The Commonwealth should not impose security requirements on small airports unless there is a genuine risk to public safety. If there is a genuine risk to public safety, the Commonwealth should fund security requirements where they result in an average cost in excess of \$10 per passenger. The Commonwealth should fund this from the revenue it receives from the Passenger Movement Charge.

9.2 Global Distribution and Discounting of RPT Routes

The State Government should require all airlines operating on all RPT routes to be on the GDS to make airfares accessible and enable the airline to participate in targeted discounting and packaging.

The State Government should require all airlines operating on RPT routes to make unused seats available for leisure packaging at discounted rates of 15% to 40%. These RPT standards can be achieved by agreement with airlines or by regulation if required.

9.3 Route Development

The State Government should redirect R4R funding from regional airport development into regional route development. The funding should be prioritised toward destinations and routes which can best attract additional visitors and therefore create additional visitor spending and jobs in the region.

Over the medium term, the State Government should aim for a minimum return of \$20 in visitor spending for every \$1 invested in route development. Over the long-term, the State Government should aim to diversify the regional economy into tourism, attract low-cost carriers and reduce public airfares on all routes by increasing the volume of leisure visitors.

9.4 Route Development – New International and Interstate Routes

A top priority for regional route development is new direct international and interstate leisure routes to regional destinations. These new routes will attract new price-sensitive leisure visitors, new visitor spending and new jobs. Top priorities for new leisure routes include Singapore-Broome and Melbourne-Kununurra.

New route development can be achieved through R4R funding to charter and underwrite patronage (not subsidising) on start-up services with co-operative contributions from local government and/or the regional airport (e.g. discounted landing fees). The tourism industry should also contribute discounted products in leisure tourism packages for the route.

9.5 Route Development – Low-Cost Carrier Routes and Longer Seasons

State funding for regional route development should also focus on:

- Attracting low-cost carriers to regional WA on new and existing interstate and international routes;
- Attracting additional low-cost carrier services on existing intrastate routes during peak seasons; and
- Lengthening the season for low-cost carriers servicing leisure routes.

The State Government should not underwrite low-cost carrier services once established, but should focus funding on Airline Marketing Partnerships with low-cost carriers supported by co-operative contributions from local government and/or the regional airport and discounted tourism products in leisure tourism packages.



9.6 Route Development – Leisure Packaging on Intrastate Routes

Leisure tourism packages can deliver discounted airfares on existing intrastate routes. State funding for regional route development should focus on programs to:

- Assist destinations develop leisure tourism packages with discount airfares on RPT routes;
- Assist tourism businesses develop contracted product for inclusion in leisure packages;
- Develop and market regional event tourism packages for attendees at Perth Stadium events; and
- Develop and market regional stopover tourism packages for passengers on the London-Perth direct service.

9.7 Regional Event Funding

Business Events and Tourism Events attract additional demand on a route and can be used to lengthen seasons in regional destinations. The State Government should redirect R4R funding away from funding events for community entertainment and focus on Business and Tourism Events which:

- Have a high ROI for additional international and interstate visitor expenditure;
- Are timed to occur during non-peak periods to extend the shoulder seasons; and
- Have secured discount airfares in packages for event attendees before R4R funding is approved.

9.8 Regional Convention & Event Centres

The State Government should also invest R4R funds in developing convention and event centre facilities which will attract national or international Business Events to a regional destination. These facilities should only be funded by R4R in regional destinations such as Broome where direct international or interstate routes exist or are being established.

9.9 Regulated RPT Routes

The State Government should focus on route development to expand demand on RPT routes and achieve greater airline competition and reduced airfares. Where there is insufficient demand to maintain competition, the State Government should regulate the route to maintain confidence in minimum services, put a ceiling on airfares and maintain competition pressure by periodically putting the route to tender.

9.10 Aviation Policy Capacity

The State Government should enhance its aviation expertise, research and policy capacity, particularly within the Department of Transport. Regional development, tourism marketing & events, transport policy and regulation should be better aligned around a consistent policy approach.

The Department of Transport should constantly monitor airline activity and fleet investment decisions and advise the State Government of opportunities, threats and policy responses.

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