

Economics and Industry Standing Committee
Level 1, 11 Harvest Street
West Perth WA 6065

26th July 2017

Dear Sir / Madam,

RE: Inquiry into matters relating to airfare prices on regular public transport (RPT) air routes in regional Western Australia

I provide this submission to the inquiry based on my past employment within the aviation industry (15+ years) in Western Australia, particularly in regional areas of the State and as a former resident of the Kimberley region for 20+ years. I should also add that I remain actively engaged in economic development in the north-west of the State and therefore regularly use RPT air services. I also state that the content of this submission is based on my own views.

Historically, it must be recognised that when Government made the decision to deregulate the aviation industry in Australia the regional areas of the country were most 'at risk' in terms of sustaining a RPT service.

Prior to deregulation the level of airfare increases were subject to Government approval and airlines were effectively working to the same 'airfare ceiling'. This meant that competition for market share was primarily based around service levels and customer satisfaction. How things have changed!

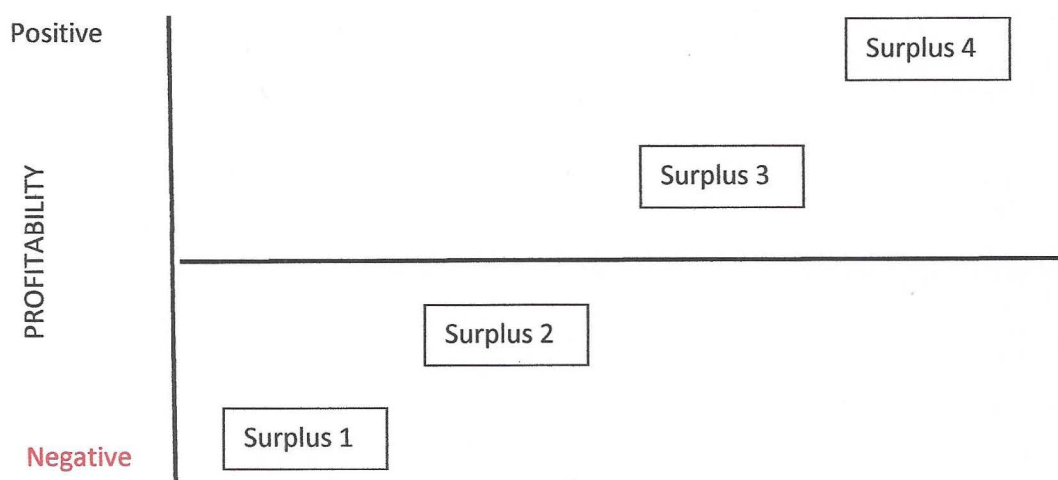
The pre-deregulation period saw the major airlines operating into regional Western Australia having far more of a social conscience. This was demonstrated through airlines commitments to Community sponsorship and support in regional locations. Today this support is virtually non-existent.

It must be said that the airlines are bound by corporate responsibilities and have a high level of accountability to their shareholders to maximise returns. They are a business and therefore have an obligation to drive 'bottom line results'. Having said that, there are a number of contributing factors impacting the high cost of regional airfares that the general public would not be aware of including:

Route Profitability Modelling

Airlines generally analyse route profitability based on a fairly simple model that ultimately categorises the profitability of a route as demonstrated in the diagram below.

For example, a 'Surplus 1' route would be considered loss-making. Such an example might be Perth – Newman. A 'Surplus 4' route would be considered highly profitable, such as Perth Karratha.



The overall profitability of a regional service clearly has an impact on the level of airfares charged. However, in the past airlines have chosen to forgo losses incurred on a regional route as part of the 'bigger picture'.

For example, a service between Perth and Newman may have a schedule that is designed to meet the needs of a large corporate client like BHP. The service is likely to be operating at a loss (e.g. \$1 million+ per annum) however the airlines make a strategic decision to absorb that loss because it is part of a national contract the airline has with BHP that may be worth \$50 million. Put simply, it is the airlines strategy to ensure they maximise 'market share' of the lucrative 'corporate dollar'.

Other examples could be the Perth – Exmouth route operated by Qantas. It could be reasonably assumed that this is a loss-making route however the airline is looking to strategically place themselves in the vent that offshore oil and gas activity increases. They are marking and protecting their territory!

Corporate Rebates

As the corporate sector (particularly through the mining / resources boom) strive to also increase their returns to shareholders they have negotiated hard with airlines to procure the best deal possible. As a result, airlines have in many ways been forced to change the 'offers' made to corporates over the last 2-3 decades.

Arrangements between airlines and corporates were previously based on agreed fares or a rebate applicable to a standard economy airfare. However this has changed considerably whereby corporates now demand that rebates are to be applied to the 'best fare of the day'.

What this means is that corporates instruct their travel arrangers (agents like Carlson Wagonlit Travel) to book the best fare of the day, against which a corporate rebate offered by the airline will be applied. Historically, these rebates were in the 30% - 40% range, however they are understood to be considerably higher (50% - 60%) today.

Yield Management

Airlines will obviously strive to maximise their yield to ensure a route operates profitably. The ability for corporates to book already deeply discounted fares, against which agreed rebates from the airline are then applied has a profound effect on the yield generated by a particular route.

The airlines provide a range of airfares with varying terms and conditions. An allocation of each fare type would typically be allocated to each flight based on target yields.

The 'best fare of the day' approach essentially means that the lower fares are primarily taken up by the corporates. These fares are ultimately even cheaper after rebates are applied. What this means is that the remaining seats (fares) on a particular flight gradually increase as the airline strives to meet target yields.

It could therefore be reasonably assumed that the leisure market and general public are bearing the brunt of the substantial rebates airlines offer to corporates. This is probably the most significant factor impacting the high cost of regional airfares. This comment is made on the basis that regardless of the fare booked by a corporate they are getting a substantial discount whereas the leisure market and general public do not.

Impacts

The impacts of high-cost airfares on regional centres has a 'ripple-effect' through small business, tourism, Community welfare and cost of living for the Community.

There are a significant number of regional centres that have some degree of mining and resources activity. For example, Kununurra (mining), Exmouth (oil and gas), Broome (oil, gas & mining), Newman (mining), Port Hedland (mining), Karratha (oil, gas and mining), Paraburdoo (mining), Onslow (oil and gas) and so on.

Past strategies to encourage the growth of regional centres have failed due to the cost of accessing the areas. The regional economies were probably considered strong during the mining and resources boom but what is the legacy? It is the ongoing struggle for regional centres to achieve a sense of balance in their economy by fostering growth in small business, retail, tourism and other industry sectors. These sectors are effectively penalised in terms of the cost of air travel by the presence of large corporate entities in the mining and resources sector.

That is not to say that the mining and resources sector is not important. It is vitally important to the State's economy overall but the consequences are largely borne by the regional centres. What message does that send? Are the regional centres not as important? Without the regional centres the industry would struggle in terms of services, products etc. Recent history has proven that.

The Airlines

There is clearly a high level of frustration in regional centres at the high cost of air travel. The airlines maintain a clinical approach to route profitability and in all honesty have no obligation to meet the expectations of anyone except their shareholders. Despite what they

might say they display no 'social conscience' or essence of being a 'good corporate citizen'. It is therefore reasonable to assume that they don't have one and essentially 'don't care'. They are running a business!

What compounds the ire of regional Community's is the weak excuses put forward by senior airline personnel when questioned about the high cost of airfares. For example, comments relating to a lack of population base. These comments are flawed when you can fly Perth to Hamilton Island (approx. population of 1,400) cheaper than you can fly Perth to Broome (approx. population of 16,000).

They also quote distance as a factor. Well why can you fly Sydney – Cairns (3 hrs 10 mins) cheaper than you can fly Perth – Broome (2 hrs 35 mins). None of it makes sense other than to say the airlines are not willing to share the truth. Admittedly they are not obliged to but that doesn't mean they should put forward lame reasons. Say nothing at all unless you can share the truth!

What can be done?

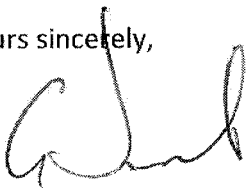
Probably very little given it is a deregulated environment. Moving back to a regulated structure is an obvious option but probably most unlikely to happen and goes against the notion of competition and free-enterprise.

Perhaps more focus needs to be put on reducing FIFO movements and having a greater number of the mining resources workforces based in the regions. Maybe then the regional centres will have a better perspective of which airlines are really interested in being part of Community.

Some might argue that FIFO and the mining / resources sector underpin many regional air services. That point should not be lost but nor should the point that it is the people residing in the regional centres that are effectively subsidising the air travel of the corporates. The effect of high-cost airfares should also be considered in terms of the impact it has on Government spending, albeit the State Government contracts with airlines are also likely to include rebates. Are public monies being well-spent?

I could write pages and pages on this issue (which is not a new one) but trust that the views expressed provide some insight into what causes regional airfares to be so high and the negative impact it has for Communities. Perhaps more knowledge about the issue may help Communities decide what sort of industry they want to embrace and how they can leverage better outcomes for the resident populations.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Grant Smart', written over the closing 'Yours sincerely,'.

Grant Smart