# INQUIRY INTO REGIONAL AIRFARES IN WESTERN AUSTRALIA

## Introduction

The Kimberley Development Commission is a Statutory Authority of the WA State Government operating under its enabling legislation the Regional Development Commissions Act 1993.

The Commission has operated with a Board, 7 staff and reports to the Minister for Regional Development. We have offices in Kununurra, Broome and Derby.

Recent Machinery of Government changes have meant that whilst the Commission is a continuing entity, the majority of its staff have been amalgamated into the new Department of Primary Industry and Regional Development. I am the CEO of the Commission, and have been since its inception in 1993. I live in the Kimberley in Kununurra.

Our enabling legislation prescribes broad functions in relation to economic and social development in the region. Whilst we have no regulatory or statutory role in relation to airservices, we work with Government, industry and the community on a wide range of priority development related matters.

We maintain a strategic level overview of many regional development issues including those that impact in the transport area. We however, operate within a broader sphere of government, and often work with Government agencies that are the subject matter experts with statutory powers.

The Commission has contributed to the submission made by DPIRD, but wishes to expand on that submission with more detail in relation to the Kimberley.

## Overarching Messages

- Regional air travel is a critical component of the social and economic network in regional Western Australia. Business and residents have an expectation they can affordably access a regular service to appropriate ports to meet personal and economic needs. Air travel costs in the Kimberley are high, relative to other areas in the nation. (ref State Aviation Strategy 2015, Current perceptions future directions study - TNS 2016)

- The pressures that influence the aviation market are amplified in the Kimberley which is demonstrably distant from all ports, particularly the Capital city, thinly populated, subject to seasonal demand and is a high cost environment to live and operate within.

- Aviation infrastructure and related service delivery is a complicated and dynamic socio – economic system, operating at scale within market dynamics that are experiencing significant adjustments largely though not exclusively, driven from in the mining and resources sector.

- External factors impacting
  - Government generally employs 'light touch' in relation to intervention in air services. (Dept of Transport evidence refers)
  - Airlines make business decisions on the basis of yield and risk.
  - Airlines operate primarily on a national and international basis where yield and risk dynamics are both at a larger scale and have greater levels of predictability.
  - Prioritisation of regional air services involve business decisions usually made on the 'east coast'.
  - As a result, regional airservices to some of the thinnest routes to the most remote areas have a priority that is lower than the heavily utilised routes. This results in prioritisation decisions that impact aircraft type, aircraft availability, flight frequency, sometimes flight times.

- Airfare pricing policies and the impacting and contributing factors are not well understood.

- Internal regional factors impacting
    - 'Segmentation' on any route or sector has to be clearly understood as it is a significant component of service design and profitability. Each route is a 'system' of segments, some linked some independent of each other, all operating together.
    - Different market 'segments' behave very differently. In the north, routes are generally segmented into:
        - Resource company and project related travel - inelastic
        - Travel to service businesses- inelastic
        - Government officer travel- inelastic
        - Health use of airservies (PATS etc) – inelastic
        - Education use of Airservices – limited elasticity
        - Community and residents travel - elastic
        - Leisure tourism travel - elastic
    - Thin routes with different 'segmentation patters' create yield and risk issues for airlines.

- Leisure tourism has high growth potential in the Kimberley. Growth potential limited by air access and cost. (ref Current perceptions future directions study - TNS 2016). Industry driven evaluation in both East and West Kimberley, points to several real and current commercial opportunities to open new services to drive increased leisure tourism. Submissions from the East Kimberley Marketing Group and the Broome Tourism industry further expand the point. Expanding the access options for Kimberley is likely to have a positive impact on scale. Scale and therefore competitiveness is what underpins more cost effective airfares.

**Additional regional data**

1. The KDC experience
2. An east Kimberley case study of local residents
3. Segmentation of the airservice market
4. The impact of mining and business users
5. Tourism and the leisure market
6. Fares on offer - Airfare Price sensitivity – regional and national trends
7. Airport charges and regional facilities
8. Aviation infrastructure – ownership and investment
9. The competitive environment
10. Growing the pie – introducing new routes
11. Regulated Kimberley Routes
12. Broome and Kununurra usage trends
13. Seasonality
14. Actions that would make a difference

**CURRENT SITUATION:**

Enhanced air services to the Kimberley region will contribute towards the development of economic opportunities that can in turn stimulate social return for the region's unique demographic profile. Quantifying that contribution and thus converting that to a proper 'return on investment' analysis is an ongoing challenge for Government and the industry.

The State's tourism goal of doubling the value of tourism by 2020 is closely linked to the capacity to provide competitive air fares to its regions.

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High airfares are a concern to many regional West Australians and considered by many to be a significant barrier to increasing regional tourism. The scale of that barrier has not been objectively quantified.

Given that airfares for leisure tourism are generally price elastic, then improved affordability of airfares on routes to major centres in Broome (BME) and Kununurra (KNX) will most likely increase the number of visitors to the Kimberley which in turn will diversify the economy and create more local jobs. The key challenge is how to best influence 'affordability'.

The mechanics of the marketplaces that drive regional airfares tend to be poorly understood. Factors influencing the markets are:

- Market segment – The various segments of the market behave differently. Some segments are price sensitive, other key components are less so.
- Size of the destination base population
- Route – A capital city connection generates greater traffic than an intra regional connection.
- Seasonality – some Kimberley destinations are highly seasonal and within these peaks (Dry: May-August), shoulders (March – May & September – October ) and off season (Wet: November - March)
- Direction of travel – some routes and time of flights show a single direction dominance.
- Degree of competition on the route

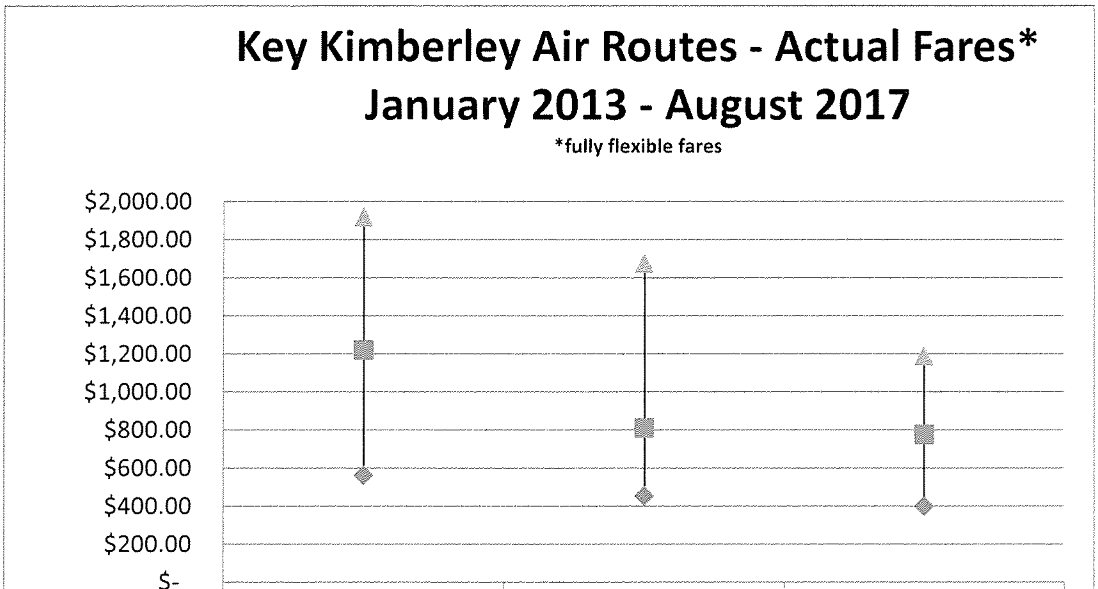
The current airfares from Perth to Broome and Kununurra create barriers for a number of residents in the Kimberley and these can result in additional costs for businesses and Government. Some of these costs are included in the table below.

| Personal Costs | Businesses Costs | Government Costs |
|---|---|---|
| • Higher cost for residents to travel and access services in other centres<br>• Decrease incentive to move to the Kimberley due to travel cost and lack of accessibility<br>• Impacts family connections/reunions/visitation due to high cost of family travel | • All industries, particularly tourism, become less competitive due to associated transport costs<br>• Higher service cost for expert technical skills<br>• Increased freight costs<br>• Harder to attract employees or costs of providing subsidies for flights | • Cost of providing subsidy services such as Patient Assisted Transfer Service (PATS)<br>• Cost of flying people for regional business<br>• Cost to Government for employees and services |

## 1. The Kimberley Development Commission Experience

An assessment of the KDC travel costs for the 4 years between January 2013 and August 2017 present the real life experience of a small government agency operating in the region. Officers are required regularly to travel.

Government experience of travel to BME and PER from KNX via any route indicates airfare is likely to be around $900-$1000 ($902 median $985 mean) for any outward leg from Kimberley airports (Figure 1). This would be the experience of business travelling at short notice or requiring flexible fares.




| | KNX - PER Return | BME-PER Return | KNX - BME Return |
|---|---|---|---|
| Lowest Fare | $564.00 | $455.00 | $400.00 |
| Median | $1,222.00 | $812.00 | $778.00 |
| Highest Fare | $1,920.77 | $1,677.00 | $1,190.00 |

## 2. Local Impact – EK Case Study of Local Residents

Social impact of access to and cost of regional airfares is not well studied or reported at a statewide, regional or community scale. There are some available data collected for specific purposes, however, research designed to examine the responsiveness of individuals to fare pricing, and the consequences of those choices is yet to be either published or commissioned by government or academia.

Some East Kimberley travel statistics (EKMG/Metrix 2015 p37).

- When residents of the EK travel out of region 85% fly, 15% drive 17% travel from KNX for business, between 1 and 6 times per year.
- 51% travel to visit friends and relatives
- 28 % travel for holiday leisure
- 4% for "other' Health, Education.

## 3. Market segments

- Recognition of different response to price (Price Elasticity of Demand) within a single fare market is critical. Different market segments respond differently to changing price.
- Hypothesis - Generalised sensitivity to fare price:

  FIFO < Government Corporate (officer travel, PATS) < Small Business < Local Community life events (medical, education, personal) <Tourist Leisure < Local Community Leisure.

| Segment | FIFO<br><br>Minerals Resources | Government Corporate (official travel, | Small Business | Local resident (medical, education, | Tourist Leisure | Local resident Leisure |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| | | **PATS)** | | **personal) life events** | | |
| Level of Discretion | Nil - Obligation – roster swings | Nil - Obligation for important meetings<br><br>PATS essential | Medium | Low – medium | High can readily and do make alternative choices reflecting market competitiveness | High – medium. (15% of KNX residents drive out of east Kimberley). |
| Alternatives to RPT | May charter or develop private airfield | May charter – limited by policy and price constraints | May charter – limited by policy and price constraints | Driving becomes less desirable further from destination – time and $ of driving | Seek other markets or destinations based on airfare & accommodation budget | Drive or seek other market/port to access flights |

- This analysis reflects the perceived level of discretion or available alternatives the buyer may have and how 'captive' is the market demand
- Leisure tourists have wide range of available alternatives outside of the regional WA market in a series of strong competitive market options.

## 4. How dominated by mining, business and travel?

- Who is buying seats is not well understood outside of the airline booking services. These arrangements are generally contractual and 'opaque' to direct analysis.
- Following FIFO demand, official Government travel is likely to be a prime customer. Despite advances in technology with phone and video conferences, face to face meetings are still required.
- In addition, there is significant state support for public servants and dependents to travel annually. For example, there are 600 public servants (and an unknown number of private businesses) in Kununurra that may be supported with a return trip to Perth for the family during each year.
- Similarly, PATS constitutes a significant portion of the regional seat capacity. For example in Kununurra, around 300 bookings to BME or PER are made each month by the Department of Health. On the assumption that this is consistent throughout the year, this represents between 8 and 16% of monthly pax movements out of KNX.

## 5. Tourism and the Leisure market segment

Tourism is a key growth industry in the Kimberley and a key element of the State Tourism Strategy, the State Aviation Strategy, Kimberley Regional Blueprint and various industry and local plans. The costs of air travel to and from the region is regularly identified as a significant inhibitor of industry competitiveness in the Kimberley. The extent to which business is inhibited by air travel costs is a complex piece of work that has not been comprehensively tackled. Various components have been addressed in industry lead work some of which has been sponsored by the Commission.

However, there are many regularly cited barriers to travel to Kimberley destinations raised in various studies, including:

- Too expensive particularly for families
- Too far away – takes too long
- Flight schedules require multi (2-3) day trips to Perth adding cost
- Strong 'value for money' competition from other destinations – It should be noted that the often repeated "Bali is cheaper scenario" becomes its own marketing campaign that works against regional visitation.

## 6. Fares on Offer and the sensitivities around fare price points

There remains considerable scope for local, regional and statewide scale research on choice modelling to reveal the buyer behaviours within each of the market segments. This is important work to inform and potentially facilitate better service outcomes.

Because fares on offer are always in a fluid and dynamic state, the consequences of these consumer choices can significantly impact the markets that are in play on each route. The yield management algorithms used by airline yield managers for driving the fare class availability is finely tuned to ensure the airline is constantly holding the price elasticity on demand as close as possible to optimum.

However, at any point with local buyers, there is a tipping point. In the absence of choice modelling, a local travel agent has identified that in Kununurra:

*' when KNX-DAR reaches $400pp (can be discounted to $99-139) each way as tipping point for leisure buyers. The choice to drive increases at that point, particularly families where cumulative fare above $2-3000 is repellent to residents.'*

While airlines offer discount fares for certain classes on most flights by the major carriers, to secure these requires booking with long lead times often, 3-6 months advance purchase.

Kununurra travel agents note that due to the frequent (quarterly or more) airfare sales available in the East Kimberley, local residents that can undertake long term planning will get the opportunity for the cheapest fares. The key sensitivities are encountered for business travel (flexible, bookings without notice or ability to capture discounted fares) or urgent personal travel require booking the best fare on the day. This is often significantly more that the fully discounted fare.

There are 10 classes of fares that generally apply from Q (fully discounted) to Y (fully flexible, high cost) with each step down representing a discount of 15-19%.

Table presenting indicative fare classes PER-BME August 2017

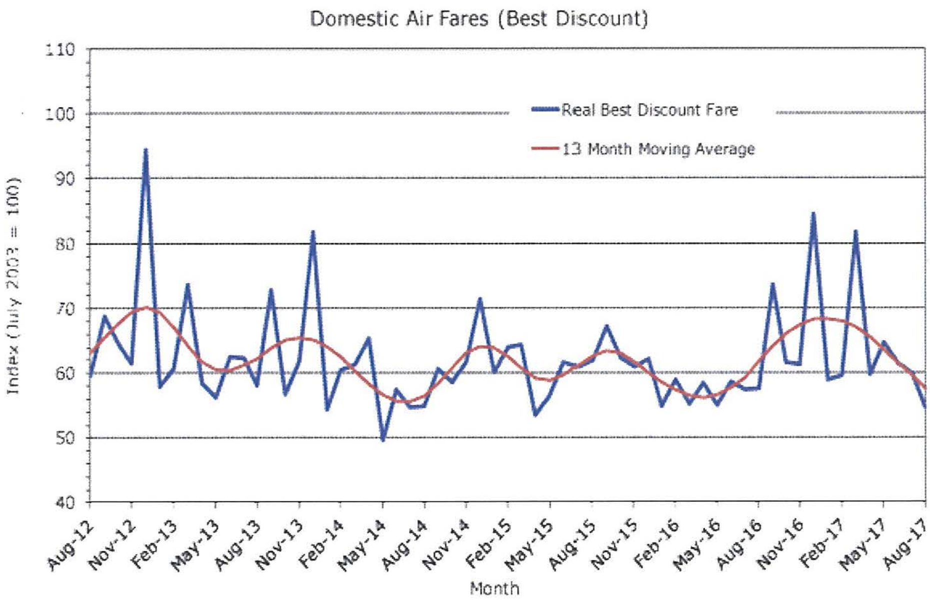
| Y | B | H | K | M | L | V | S | N | Q |
|---|---|---|---|---|---|---|---|---|---|
| $1,208 | $1,027 | 828 | 724 | 624 | 538 | 476 | 403 | 341 | 275 |

- Airlines run discounted 'sales' regularly. Qantas report 20% of the time, Virgin around every 4 months (re: Kna Travel agent)
- Within the 10 classes, the discounted fares may be sold to bulk buyers, but FIFO generally secure separate 'contract rates' that may reflect the low to middle fare classes. Result is, once the discount seats are purchased, the next step is 'leapfrog' over FIFO block into higher fare classes.

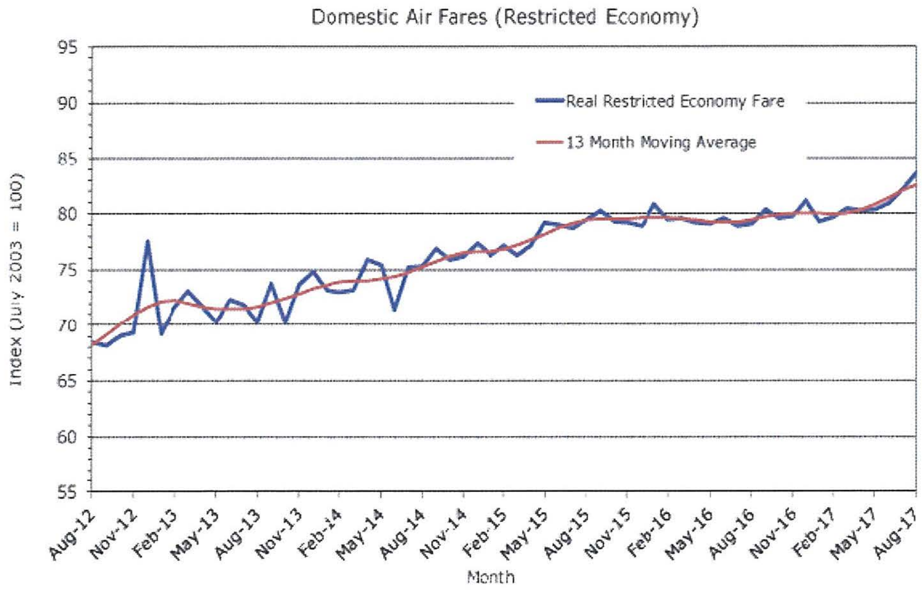
- This becomes complicated on a multi leg flight where around 50% of all seats are transit passengers. (eg Darwin DAR to KNX), total 'sales' seats are available on the capacity of the plane and not multiples of each leg. Eg the KNX – BME seat buyer is also competing with the DAR – BME buyer on this leg.
- Nationally, the index on Best Discount fares is currently trending downwards, indicating that the maximum discount offered is significantly less than restricted economy (around index 60 vs index 83). However, this is set against a rising trend in real Restricted Economy Fares.
- The 2015 state Aviation Strategy indicates that WA intrastate airfares are the highest in the nation.

  *"While airlines cite lower passenger numbers (hardly true of Pilbara airports and Broome) and higher costs and lower load factors in WA on the back of predominantly business-corporate travelling market in WA. Western Australia is the only state in Australia where the relatively price insensitive business-corporate market predominates over price sensitive markets for leisure and visiting friends and relatives. Airlines in WA can fill their planes with passengers paying high fares in a way they cannot in other states. In this situation, there is little or no incentive for a low-cost carrier to operate (such as Jetstar in Queensland)." (Ref: WA State Aviation Strategy 2015, page 77)*

  If the dynamics described in this exerpt are accurate, then there is likely to be an impact across all regional WA routes serviced by the main carriers, because aircraft deployment, marketing and yield management are all interlinked parts of connected businesses. Better understanding market segmentation impacts is a priority.




- BITRE do not publish data providing the state average for best discount or restricted economy fares and given the FIFO resources demand has softened, the WA market response is unlikely to be consistent with the national picture with larger more influential commercial drivers on high volume east coast routes.




https://bitre.gov.au/statistics/aviation/air_fares.aspx

## Airlines Position on Service Delivery in Regional WA

- Resources sector (FIFO) services are the 'foundation customer' for many routes, however, these are undergoing significant change'.
- Most FIFO seats are contract sales and not purchased from discounted offerings. The yield management algorithm /calculations used by airlines may have the effect of progressing a booking to the higher cost fare class as 'best fare of the day', if block booking of fare classes is in play.
- Virgin reports seat capacity down by 8% nationally and 24% in regional WA.
- Without strong FIFO base demand, Frequency and capacity will likely be negatively impacted. Fare pricing may be impacted as a consequence. 'Right sizing' the fleet will continue to constrain supply and place upward pressure on leisure and local travel.

## 7. Airport Charges and Regional Facilities

- Airport charges are considered by both major carriers as being expensive. For example Qantas claim that nationally 8 of the 15 most expensive airports are in regional WA.
- Costings presented in the table below reflect the additional operating and maintenance costs of operations in the remote and very remote locations in the Kimberley

| Airport | Passenger Charge | Passenger Screening Fee (per passenger) | Total | Aircraft Charge (per tonne) | Aircraft Charge (per pax) F100 [3] | Aircraft Charge (per pax) E170 [4] |
|---|---|---|---|---|---|---|
| Derby[1] | 12.92 | 11.86 | **$24.78** | 18.7 | 8.41 | 8.86 |
| Broome[1] | 20.37 | 13.24 | **$33.61** | 23.65 | 10.64 | 11.20 |
| Kununurra[2] | 20.9 | 21.6 | **$42.50** | 29 | 13.05 | 13.74 |

1 Shire of Derby West Kimberley - Derby Airport Redevelopment EIA/BCA 2015
2 Shire of Wyndham East Kimberley - Annual Budget 2015-16

3 Fokker 100 45 tonnes and 100 pax
4 E170 36 tonnes and 76 pax

- Some airlines seek to avoid fuel price premiums in regional areas by carrying fuel for return journey. The resultant weight penalties can have undesirable outcomes for passengers faced with decreased loading limits. It is argued that this cost could contribute to an element of fare structure.
- Charges are designed to reflect significant capital investment to improve airport facilities (airside and land side).
- In some instances Local governments carry some financial risk with the management of regional airports associated with the viability of air routes.

**8. Ownership and recent investment in Kimberley Aviation Infrastructure?**

- The impact of airport infrastructure and land side and air side costs on airfares and the provision of air services is not well quantified. These are matters that have been generally canvassed in the State Aviation Strategy, along with the relative competitiveness of various airports.
- The Kimberley's airports have benefitted from varying infrastructure improvements in recent years, with most are now at a serviceable level that meets existing needs.
- It should be noted that improved infrastructure, carries with it a responsibility to maintain and manage it. Irrespective of whether the work was funded by the airport owner or the State or Federal Government, upgrades generally result in increased costs being passed to operators which creates a price pressure.

| **Location** | **BME** | **DBY** | **KNX** | **HCK** |
|---|---|---|---|---|
| Ownership | Private | Shire and Dept of Defence | Shire | Shire |
| Recent investment | Private | Govt RADS investment – Commonwealth investment | — Ord Expansion Project EK Regional Airport New Terminal | Apron and Fencing - RADS |

**9. Who are the RPT operators and what is the level of competition?**

| **Routes** | **Carrier** | **Frequency** | **Capacity** | **Trend** |
|---|---|---|---|---|
| BME - PER | Qantas<br>Virgin Australia | 268 flights for the yr to April 2017 (294 for the year to April 2016) | 31,400 seats<br>72.8% Load factor | -8.8% |
| BME-KNX (DAR-KNX-BME) | AirNorth | Daily | 76 pax on E170 (but approx. 50% transit from DAR) | Approx. 2% decline but stabilising post 15% year on year dip 2013-2015 |
| KNX - PER | Virgin Australia | Sun, Mon, Tues, Fri | 100 pax on F100 | Growth approx. 8% |
| KNX – HCK | Aviair | Mon Wed Thurs | Cessna caravan | New service – trend data not available |

**10. Growing the pie – introducing new routes.**

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There is considerable interest and activity within the tourism industry in both the east and West Kimberley, to improve leisure tourism through the introduction of new routes independent of the services dominated via the carriers that hub from Perth.

These are industry initiatives and the new services being contemplated will be more fully outlined within industry submissions.

The underlying rationale is for industry and its partners to open new connections to markets that have previously not been available to the Kimberley, capitalising on the region's development opportunities.

The proposals are well advanced and with small amounts of facilitation and related marketing may provide opportunities for a step change increase in regional visitation. Ramped up regional marketing holds the key to attracting improved services and facilitating increases in scale.

The proposals are being developed by industry and the Commission has supported both concepts.

## 11. Regulated Routes

The existence of regulation of Regular Public Transport (RPT) intrastate air services illustrates the importance to Government of safe, affordable, efficient and effective air travel to regional Western Australia. The level of regulation and intervention in commercial airservice markets is generally considered 'light touch'. Ref: Dept Transport evidence.

Of the 12 in WA, the Aviair Halls Creek to Kununurra is the only Kimberley Regulated RPT.

**REGULAR FLIGHTS BETWEEN HALLS CREEK AND KUNUNURRA START ON 4TH JULY**

| TIMETABLE | Depart KUNUNURRA | Arrive HALLS CREEK | Depart HALLS CREEK | Arrive KUNUNURRA |
|---|---|---|---|---|
| Monday | 10.00am | 11.15am | 12.00pm | 1.15pm |
| Wednesday | 6.15am | 7.30am | 1.15pm | 2.30pm |
| Thursday | 6.15am | 7.30am | 12.50pm | 2.05pm |

FARE CLASSES

Fare $150 – Halls Creek Residents / Remote Area Subsidy Scheme (RASS) passengers
Fare $325 – Non-residents of Halls Creek/ general business traveller
Fare $415 – State Government Workers.

There is an online login for Government agencies.
Strict conditions apply to the fare classes and checks will be conducted.

**RASS passengers need to book over the phone.**
**Book online at www.aviair.com.au**
**or call us on 9166 9300.**

aviair

The Perth to Derby flight was cancelled last year as the resource company underwriting the flight withdrew support. The State Government has made a commitment to support a one year trial of this route.

## 12. What are the trends for each port and how *thin* are the routes?

- Total annual PAX movements <100,000 is roughly the point at which competition on the route can be reasonably sustained.(ref: Dept Transport)
- Under 100K PAX movements may be considered 'thin'

*National standing - Top 50 Regional Airports on total pax movements*

- Broome is ranked 15th
- Kununurra is ranked 38th

| Top fifty regional airports (000s) — passenger movements, annual | | | | |
|---|---|---|---|---|
| Rank | Airport YE | Apr-16 | YE Apr 2017 | % Change |

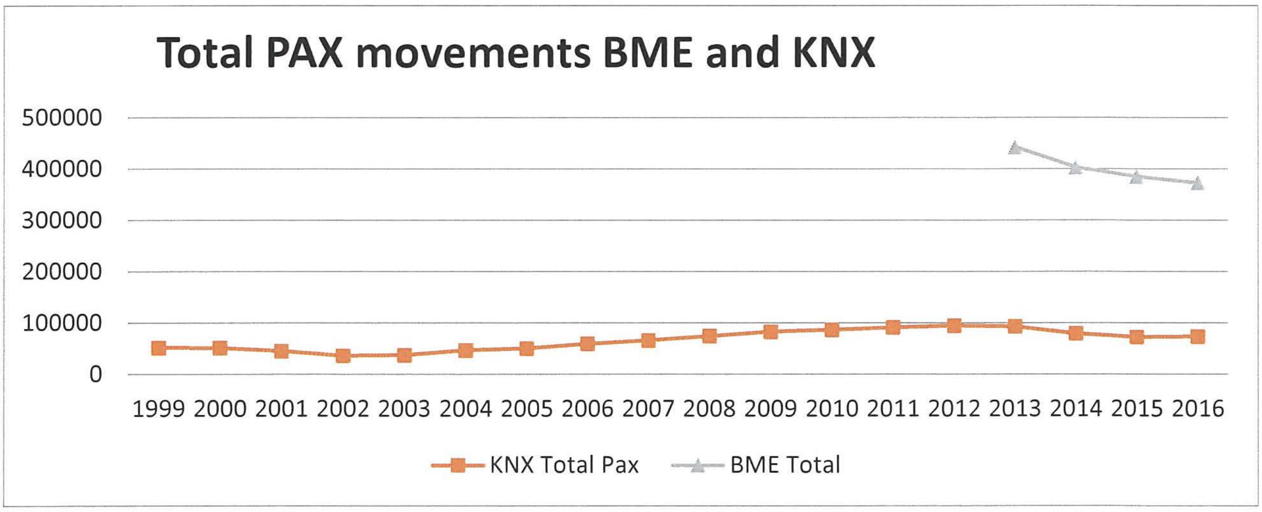
| | | | | |
|---|---|---|---|---|
| 15 | Broome | 388.1 | 362.5 | -6.6 |
| 38 | Kununurra | 103.9 | 104.4 | 0.5 |
| Total top 50 regional airports | | 22493.4 | 22818.9 | 1.4 |
| Total regional airports | | 23800.1 | 24152.1 | 1.5 |
| Total domestic network | | 116247.8 | 118194 | 1.7 |

(Source Department of Infrastructure and Regional Development BITRE 2017)

*National standing - Top 65 Competitive Routes*

- Broome – Perth city pair is ranked 39th[th] on annual total pax movements activity and 38[th] on monthly activity, available seats, load factors

| TOP COMPETITIVE ROUTES | | | | |
|---|---|---|---|---|
| Passengers carried (000s) — annual activity | | | | |
| Rank | City Pair | Apr-16 | YE Apr 2017 | % Change |
| 39 | Broome | 303 | 287 | -5.3 |
| Total domestic network | | 58123.9 | 59097 | 1.7 |
| Passengers carried (000s) — Monthly activity | | | | |
| 38 | Broome | 25.1 | 22.9 | -8.8 |
| Total domestic network | | 4837.7 | 4938.6 | 2.1 |
| Available Seats (000s) — Monthly activity | | | | |
| 38 | Broome | 36.1.1 | 31.4 | -12.9 |
| Total domestic network | | 6375.2 | 6339.3 | -0.6 |
| Load factors (%) — Monthly activity | | | | |
| 38 | Broome | 69.5 | 72.8 | 3.3 |
| Total domestic network | | 77.1 | 79.5 | 2.4 |



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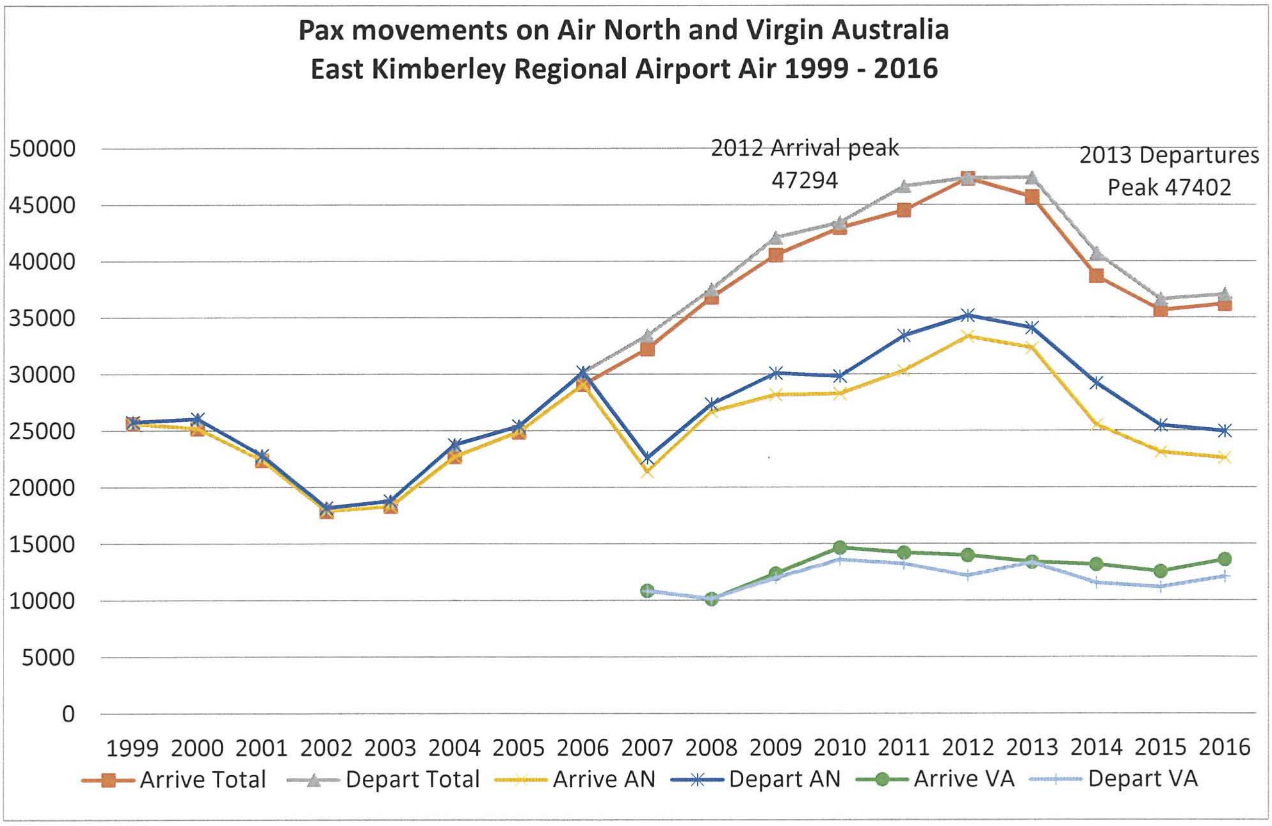
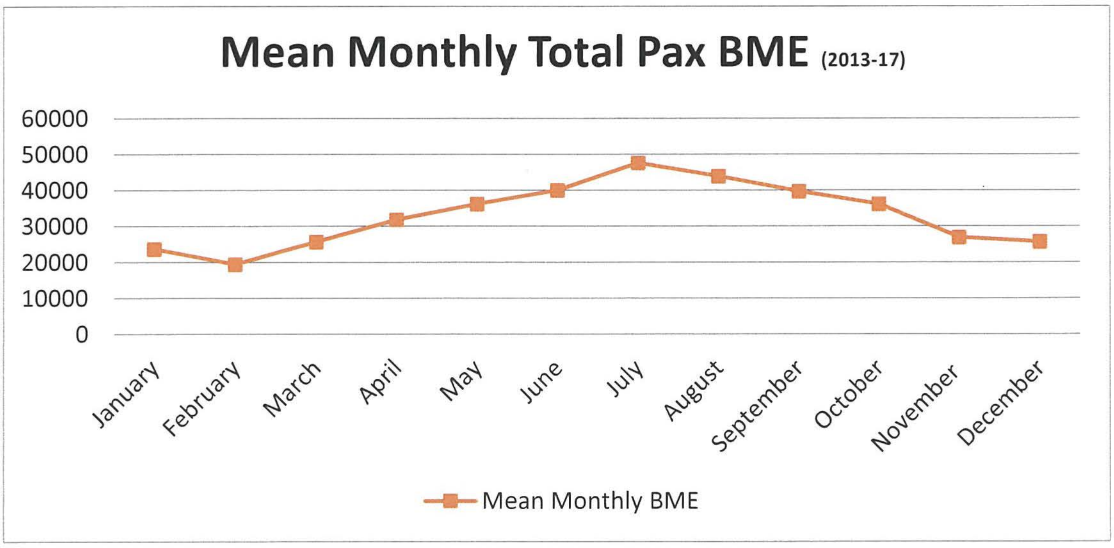


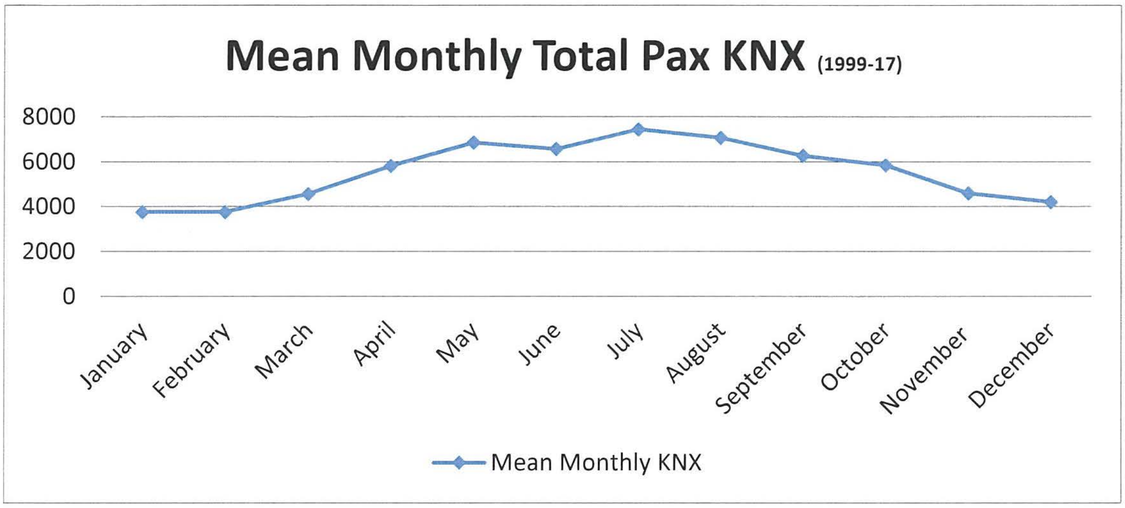

## 13. Seasonality

Kimberley air travel demonstrates distinct seasonality as demand for Kimberley destinations peaks during tourist season in the winter/Dry (May-August), shoulders (March – May & September – October ) and off season during the Wet (November - March).

Total passenger movements may double from the low traffic during the wet season. Figures below present data for BME and KNX. While the volumes in Broome are consistently greater than KNX by a factor of 5.2 to 6.4, the peak tourist season more than doubles the total pax managed during the low season of the summer wet.




Source: Broome Intl Airport data




Source: NAS airport data

## 14. ACTIONS THAT WOULD MAKE A DIFFERENCE

1. A data driven approach

1.1 Consistent with the DPIRD submission, an evidence base, properly designed, analysed and communicated to Government, business users, the airlines, the regional community and leisure tourists, could improve transparency and reduce the conjecture around what drives the pricing of airfares in regional WA

1.2 Market segmentation studies have been done for some routes, however to better understand the issues facing airlines, industry and regulators, that work could be significantly expanded, particularly into routes that have high levels of impact for community and industry.

1.3 'Choice modelling' based on improved understanding of market segmentation will provide the basis of better informed policy, more targeted industry marketing and enhanced airline decision making.

1.4 Quantitative tools to monitor regional prices and report on qualitative consumer attitudes to airfares could be developed within the Regional Prices Index and Living In the Regions Surveys processes managed by the former Department of Regional Development now DPIRD.

2 An integrated approach

2.1 A whole of government /whole of state approach may enable the various agencies of Government to facilitate improved outcomes in policy, tourism, regional development.

2.2 Consider the return on investment for a ramped up marketing program that would underpin improved air services.

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