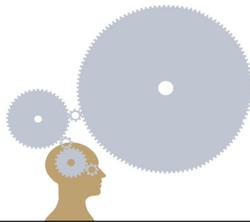


## The curious case of Flybe: predatory entry as a theory of harm

BIICL evening seminar

Simon Pilsbury, Managing Consultant

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### Predation on NQY–LGW?

- the facts of case do not lend themselves to predation on NQY–LGW
- predation difficult for new entrant on route
  - asymmetry of sunk costs works against entrant
  - no brand loyalty
- ASW also took actions to defend its position
  - advertising
  - entering GDS
- actual exit on the city pair was by Ryanair

## OFT's theory of harm

- entry on the NQY–LGW route could eliminate ASW as a competitor on all routes
  - thereby benefiting Flybe's services operating from EXT
- cannot just lead to withdrawal from route in question
  - could not represent abuse of a dominant position since Flybe is not dominant on NQY–LGW
- conditions for this to (potentially) occur are quite specific

## Required conditions (I)

- 1) ASW must make 100%+ of its profits on LGW–NQY
  - that is, making a loss on LGW–NQY would imply ASW as a whole making a loss; otherwise, it could exit LGW–NQY and continue other routes
  - begs the question: why does ASW operate these other loss-making routes?
    - in most circumstances, a private company would withdraw from products that were not profitable
- 2) ASW must not be able to make itself profitable again by dropping a sub-set of unprofitable routes
  - or it could drop these routes along with the LGW–NQY route and continue in operation

## Required conditions (II)

### 3) losses must not be due to inefficiency

- either on NQY–LGW (post-entry) or other routes
  - or entry could have pro-competitive effect of forcing ASW to become more efficient
- ⇒ the most likely reason for these conditions to be met seems to be high economies of scale/scope
- whether there are such economies of scale/scope is an empirical question

## Required conditions (III)

### 4) entry must be able to reduce ASW's profits on NQY–LGW below zero (?)

- it is possible that ASW as a whole could make losses even if NQY–LGW profitable
  - would this be predation?
- could it be enough to lower NQY–LGW profits?

### 4a) it cannot be a very large incumbent advantage

- or ASW would be able to fight off entrant
  - would also make attempted predation very costly (see point 6)
- implies limited brand loyalty/learning-by-doing effects

## Required conditions (IV)

5) must be separate market for NQY–LGW from NQY–STN

- or Ryanair would already have imposed an active competitive constraint on Air Southwest
- removing the ability to use NQY–LGW profits to cross-subsidise other routes
- and any attempt to predate could have provoked a price reaction from Ryanair
- potentially significantly increasing Flybe's costs of entry

## Required conditions (V)

6) must be rational for Flybe to predate

- generally implies need for recoupment
  - including, for predatory entry, low entry costs
- can recoupment be on NQY–LGW route?
  - if so, moves away from 'associated markets' theory of harm
  - if not, incentives to predate may be understated

6a) therefore requires passengers to be willing to switch from PLH to EXT

- switching between airports is a method by which associated markets link works

## Required conditions (VI)

### 6b) Flybe must not be effectively constrained on its EXT routes

- or will not be able to recoup, as it will earn a normal level of profitability even after ASW exit
- implies that services at Bristol cannot be effective competitors

### 7) there must not be re-entry at PLH

- or recoupment would fail as passengers diverted back to the entering airline

## Remedies

- difficult to come up with adequate remedies in this case
  - particularly after Ryanair's exit
- most likely remedy would be to force Flybe to exit the route
  - setting minimum prices difficult due to the dynamic pricing used by Flybe (and most airlines)
- but this would leave ASW as the sole operator on NQY-London
  - OFT entrenching a monopoly?

## Implications

- there are numerous conditions required for the associated markets theory of harm to hold
  - a greater number than in straightforward predation
- conditions likely to be fulfilled in relatively few markets
  - and potentially difficult to demonstrate to adequate standard even in some of these?
- likely to make investigations onerous and contentious
  - fit with OFT's prioritisation criteria?
- remedies difficult to find in cases of predatory entry
  - OFT actions have scope to create (perceived) barriers

## Glossary: IATA airport codes

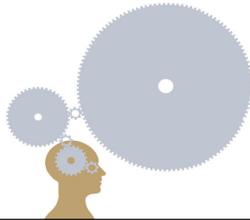
- NQY: Newquay Cornwall Airport
- LGW: London Gatwick Airport
- STN: London Stansted Airport
- PLH: Plymouth City Airport
- EXT: Exeter Airport

[www.oxera.com](http://www.oxera.com)

Contact:

Simon Pilsbury

+44 (0) 207 822 2675  
[simon.pilsbury@oxera.com](mailto:simon.pilsbury@oxera.com)



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