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

BIICL evening seminar
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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
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