

## The changing state of Australia's domestic aviation industry

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### Abstract:

The last 18 months in the lead up to deregulation of domestic aviation in Australia has been dynamic. In this paper, designed to provide an indication of the level of industry activity prior to deregulation, the industry is reviewed over periods of time both before and after the pilots dispute, and some of the effects of the pilots dispute on the aviation industry are considered. The paper also considers the initiatives by the established airlines and the progress of potential new entrants in the lead up to deregulation.

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## **Introduction**

On 31 October 1990, interstate domestic aviation in Australia will be deregulated. This event represents a fundamental change in the domestic aviation environment and a watershed in industry-wide operations and market trends.

The purpose of this paper is to review the key events and developments leading up to deregulation of the industry, focusing particularly on:

the effects of the pilots' dispute on the aviation industry and the deregulatory environment;

the initiatives of the incumbent airlines in the lead up to deregulation;

the progress that the major potential new entrants have made in their intentions to provide airline services after deregulation; and

the expectations for and influences on airline passenger growth after deregulation

The sequence of events and arrangements for the rebuilding of air services after the pilots' dispute has been adequately documented elsewhere and so has not been recounted. Rather, this paper is concerned with the effects of the dispute on the aviation industry.

## **Industry Overview**

The past fifteen years have reflected the dynamic nature of Australia's domestic aviation industry. Following strong growth in demand up to 1979/80, Figure 1 shows that industry growth plateaued before going into decline with the economic recession which turned around at the end of 1982/83. This was followed by strong growth in the six years up to 1988/89. The average annual growth rate for the industry over the decade to June 1989 of around 3 percent, is not indicative of the industry. Following the decline in traffic levels between 1980/81 and 1982/83 the industry grew at an average annual rate of over 5 percent for the remaining period to 1988/89, with particularly high annual growth of over 9 percent for 1987/88 when traffic levels were boosted by the events of the bicentenary celebrations and World Expo 88 during the year.

The pilots' dispute which commenced during August 1989, along with other industrial action earlier in the year, was largely responsible for the number of passengers carried by the domestic airlines declining by 30 percent during 1989/90.

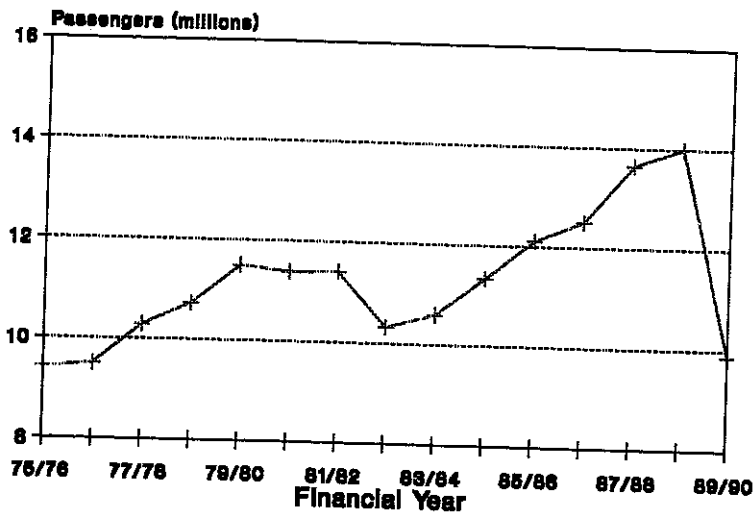


Figure 1: Domestic airline passengers uplifted, 1975/76 to 1988/89

The real effect of the dispute can be assessed against predictions made by the Bureau of Transport and Communications Economics (BTCE), prior to the dispute, which had shown an expected zero growth in traffic levels for the 1989/90 year (BTCE 1989).

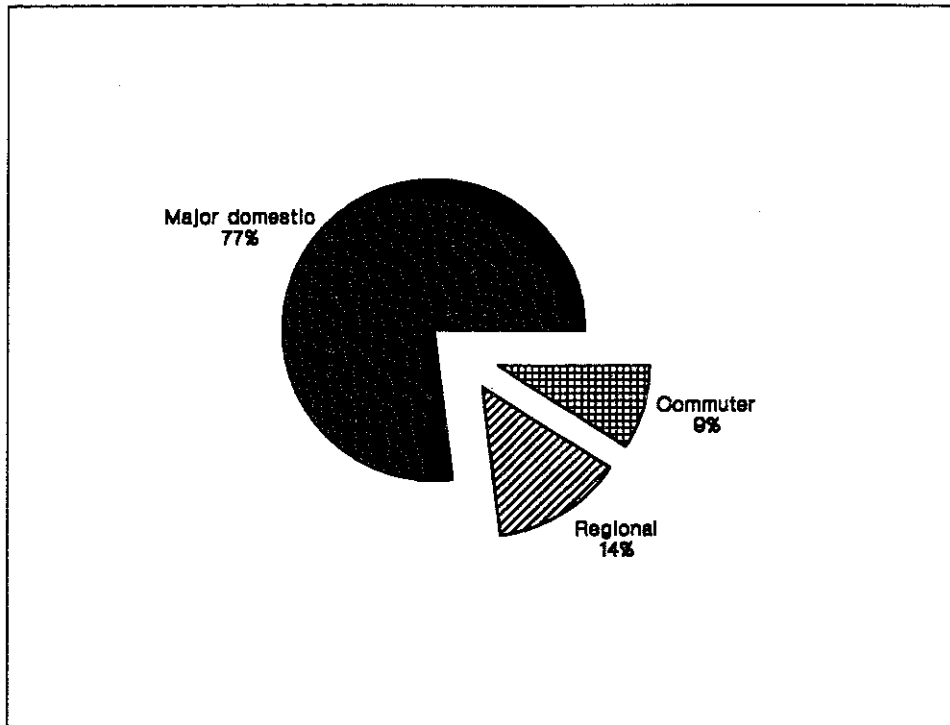
The rebuilding of the airlines following the pilots' dispute saw the supply of domestic airline capacity (comprising of the major "trunk" and regional airlines) for the total network return to at least the levels for corresponding periods in 1989 by May of 1990. On the demand side, while passengers carried returned to similar levels achieved for the same time last year by April, the levels have not been maintained consistently. The airlines' restoration of capacity to pre-dispute levels, has been achieved with considerable network and schedule restructuring on their part. This has resulted in some inconsistencies in the level of services being provided across the network when compared to the airlines' pre-dispute networks. The rebuilding process generally progressed more rapidly for the major capital city routes.

**Effects of the pilots' dispute**

In order to show the impact of the pilots' dispute on the industry and the airlines' tactics in the lead up to deregulation, it is proposed to view the industry over the three years to 30 June 1989, before the pilots' dispute, and also provide a snapshot of the industry at 30 June 1990, after the dispute.

**Industry view over three years to 30 June 1989**

For the year ending 30 June 1989 around 15.3 million passengers were carried by the Australian airline industry, including both domestic and commuter airline activity. Figure 2 shows the breakdown of passengers carried by the three sectors of the industry providing scheduled services, where the major domestic airlines carried 77 percent, the regional airlines carried a further 14 percent and the commuter operators carried 9 percent of airline passengers for the year.



**Figure 2: Market share by operator category for scheduled passenger services, 1988/89.**

### *Changes in domestic aviation*

Traffic growth in terms of revenue passenger kilometres (RPKs) performed by the airlines on scheduled services for 1988/89 was 3.5 percent. This growth rate is slightly above the average annual growth rate of around 3 percent that was achieved over the last decade until the pilots' dispute, however it is considerably lower than the 9 percent growth that was achieved in the previous year which was attributable to the stimulation of demand by the bicentenary celebrations and Expo 88. The lower growth rate for 1988/89, which also contained the effects of the bicentenary and Expo, was largely due to the reduced volume of traffic carried during the first half of 1989 compared to the same period in 1988. In order to place traffic levels for the first half of 1989 in perspective, traffic was depressed as a result of:

- travel plans largely being brought forward during 1988 to coincide with the bicentenary and Expo; and

- industrial action taken by air traffic controllers and airline support staff during the first half of 1989, which had an adverse effect on travel plans.

Despite these occurrences, traffic levels for the first half of 1989 were however, greater than for the first half of 1987.

The number of ports served by the domestic airlines declined over the three years to June 1989 from a total of 95 ports at June 1986 to a total of 68 ports at June 1989. The decline in ports served by the domestic airlines was counter balanced by an increase in the number of ports served by the commuter operators and also resulted in increased services to some ports by commuters where they already operated complementary services at the time the domestic airlines ceased services to the port.

The decline in the number of ports served by the domestic airlines reflects an increase in the concentration of services to larger population centres. The rural centres continued to be served by the commuter operators to carry passengers on relatively short-haul trips to the major regional centres and capital cities where passengers then transfer to the domestic airlines for longer haul trips between major regional centres and capital cities. The increased concentration of services to particular key centres is reflected by a decline in departures recorded for the domestic airlines, but at the same time the performance of the airlines, in terms of RPKs performed, has increased. This increase in RPKs performed by the airlines reflects the longer average stage distance being operated by the airlines, evidenced by the increase from 700 kilometres in 1986/87 to 780 kilometres in 1988/89.

The major network features in the industry at 30 June 1989 are summarised in the top 30 domestic routes, listed in Table 1. At that time:

- the top five routes accounted for 43 percent of the total number of passengers carried by the domestic airlines;

- the top ten, accounted for 58 percent of the total; and

**TABLE 1: TOP 30 ROUTES SERVED BY DOMESTIC AIRLINES,  
FOR 3 MONTHS ENDING 30 JUNE 1989**

|     | Route                  | Passengers       | Percentage<br>of total | Load<br>factor<br>(%) |
|-----|------------------------|------------------|------------------------|-----------------------|
| 1.  | Melbourne-Sydney       | 598,029          | 17.5                   | 73.3                  |
| 2.  | Brisbane-Sydney        | 354,303          | 10.4                   | 66.9                  |
| 3.  | Adelaide-Melbourne     | 197,849          | 5.8                    | 75.2                  |
| 4.  | Coolangatta-Sydney     | 156,730          | 4.6                    | 71.1                  |
| 5.  | Canberra-Sydney        | 149,540          | 4.4                    | 60.3                  |
|     | <b>Total top 5</b>     | <b>1,456,451</b> | <b>42.6</b>            |                       |
| 6.  | Brisbane-Melbourne     | 125,896          | 3.6                    | 76.0                  |
| 7.  | Adelaide-Sydney        | 118,313          | 3.4                    | 75.3                  |
| 8.  | Canberra-Melbourne     | 103,809          | 3.0                    | 54.1                  |
| 9.  | Brisbane-Townsville    | 101,365          | 2.9                    | 76.8                  |
| 10. | Melbourne-Perth        | 94,409           | 2.7                    | 80.3                  |
|     | <b>Total top 10</b>    | <b>2,000,243</b> | <b>58.1</b>            |                       |
| 11. | Launceston-Melbourne   | 91,966           | 2.6                    | 73.8                  |
| 12. | Hobart-Melbourne       | 85,152           | 2.4                    | 74.0                  |
| 13. | Cairns-Townsville      | 65,978           | 1.9                    | 51.7                  |
| 14. | Perth-Sydney           | 63,916           | 1.8                    | 77.5                  |
| 15. | Adelaide-Perth         | 60,344           | 1.7                    | 77.8                  |
| 16. | Brisbane-Rockhampton   | 59,983           | 1.7                    | 72.4                  |
| 17. | Brisbane-Cairns        | 52,551           | 1.5                    | 73.4                  |
| 18. | Melbourne-Coolangatta  | 52,215           | 1.5                    | 73.9                  |
| 19. | Alice Springs-Darwin   | 45,781           | 1.3                    | 80.6                  |
| 20. | Adelaide-Alice Springs | 42,008           | 1.2                    | 78.0                  |
|     | <b>Total top 20</b>    | <b>2,620,137</b> | <b>75.8</b>            |                       |
| 21. | Karratha-Perth         | 30,432           | 0.9                    | 74.6                  |
| 22. | Mackay-Rockhampton     | 26,568           | 0.8                    | 39.7                  |
| 23. | Devonport-Melbourne    | 25,640           | 0.7                    | 71.4                  |
| 24. | Kalgoorlie-Perth       | 25,607           | 0.7                    | 68.8                  |
| 25. | Alice Springs-Sydney   | 24,664           | 0.7                    | 63.0                  |
| 26. | Brisbane-Coolangatta   | 23,246           | 0.7                    | 31.9                  |
| 27. | Coffs Harbour-Sydney   | 22,548           | 0.6                    | 68.0                  |
| 28. | Albury-Sydney          | 21,653           | 0.6                    | 65.0                  |
| 29. | Sydney-Tamworth        | 19,192           | 0.5                    | 54.1                  |
| 30. | Hobart-Launceston      | 17,272           | 0.5                    | 39.4                  |
|     | <b>Total top 30</b>    | <b>2,856,959</b> | <b>82.5</b>            | <b>n.a</b>            |
|     | <b>Other Routes</b>    | <b>561,705</b>   | <b>17.5</b>            | <b>n.a</b>            |
|     | <b>TOTAL</b>           | <b>3,418,664</b> | <b>100</b>             | <b>71.1</b>           |

Note: Passenger figures are traffic on board by stage which detail the aggregated (including transit) movement of revenue traffic from one airport to the next, regardless of the ticketed origin and destination.

the top 30 accounted for 83 percent of the total.

The top ten routes reflects the dominance of eastern Australia in the aviation industry, with the routes predominantly consisting of east coast capital cities and Queensland tourist destinations.

#### Industry snapshot at 30 June 1990

Reduced traffic levels for the year ended 30 June 1990 are primarily a result of last year's pilots' dispute and the rebuilding of the domestic airlines. The 1989/90 traffic levels fell 30 percent since the 1988/89 year, with approximately 9.9 million passengers being carried for the 12 month period.

Since the dispute the airlines have taken the opportunity with diminishing lead time to deregulation to rebuild their operations with a 50 percent reduction in the number of pilots employed and have also negotiated some productivity increases with other employment sectors of the airlines such as Licensed Aircraft Maintenance Engineers.

After the boom period for domestic air travel during 1988 the demand for air travel during 1989 was severely reduced by a number of other events prior to the pilots' dispute. Delays associated with congestion at Sydney airport and ongoing industrial action by air traffic controllers were responsible for the start of growing dissatisfaction among air travellers due to the uncertainty associated with flying. The pilots' dispute provided a further frustration to air travellers. During the first half of 1990 traffic levels were returning to the pre-dispute levels of the corresponding months in 1989, shown in Figure 3. Also, overseas short term arrivals which accounted for around 12 percent of domestic passengers for 1988/89, had not proven to be deterred by the pilots' dispute according to figures to April 1990 from the Australian Bureau of Statistics.

By April 1990, traffic levels had virtually returned to the pre-dispute level of the corresponding month in 1989. Figure 3 shows however, that this achievement was not able to be maintained for the following 2 months. The airlines have ascribed this situation to a "softening" in demand due to the slowing down in the Australian economy rather than an ongoing effect of the pilots' dispute. Since April, the airlines have exercised capacity controls in order to maintain higher load factors and Australian Airlines has offered several of its aircraft for lease overseas due to an excess of capacity.

The incumbent airlines have since had the task of rebuilding after the dispute, and restoring the demand for air travel. This has brought forward the airlines' introduction of new strategies and initiatives in marketing of the product they provide to their customers. In effect, Ansett and Australian Airlines have already begun to operate to some extent as they intend to after deregulation. The interruptions to services

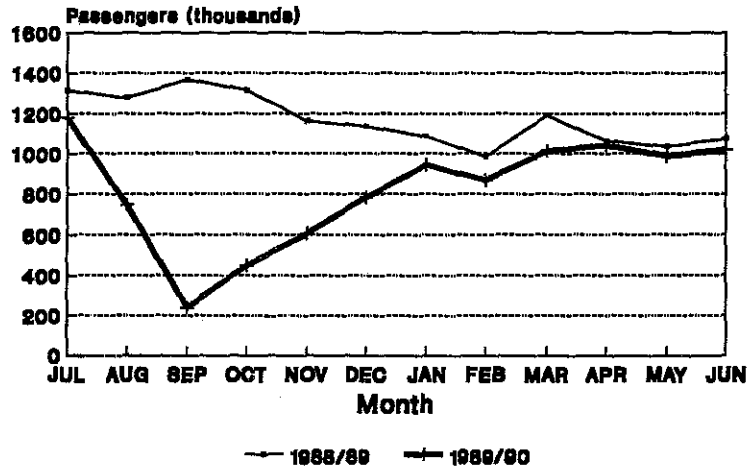


Figure 3: Domestic passengers carried by month, 1988/89 and 1989/90

following the pilots' dispute has increased the airlines scheduling flexibility because, due to the reduced capacity that they provided during their rebuilding, the airlines are now well under their capacity determinations, which would otherwise have imposed a restriction on capacity under the two-airlines policy to ensure that Ansett and Australian are allocated the same capacity on their competitive route networks. Having said this, the airlines are currently still restricted by the two-airlines policy to the extent that they need approval to import aircraft and new fares require Independent Air Fares Committee (IAFC) approval.

The airlines have seized the opportunity to embark on new marketing campaigns to win back the confidence of consumers. As well as innovations in marketing with giveaways such as cars, a year's free travel and the like, the airlines have produced new schedules with significantly different route networks, that reflect more closely the services that they intend to provide upon deregulation. The airlines have also begun offering large discounts on selected fares, with as much as 50 percent off economy fares for advance purchases on some off peak flights and 40 percent discounts for senior citizens.

*Network and schedule changes:* Since the dispute, Ansett and Australian have begun to experiment with changes to network structures, resulting in a greater number of direct



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services on some routes which previously had received indirect services. At the same time, ports that were predominantly intermediate ports previously, are receiving a lower frequency of services but this is resulting in more available capacity on such routes. This is being achieved as a result of the whole aircraft being devoted to one city pair, instead of only say, 70 percent with the other 30 percent being occupied by transit passengers flying on to the next port. Examples of these types of service changes are:

the Brisbane - Rockhampton - Mackay route; and

the Melbourne - Launceston - Hobart route.

Increased direct services between Brisbane - Mackay and Melbourne - Hobart with less services to the intermediate ports is providing increased capacity overall on the routes. The cost effectiveness of this approach as opposed to serving intermediate ports en-route to a destination is dependent upon the load factors that are being achieved on the direct services.

Capacity on a network-wide basis for domestic air services after the dispute surpassed levels for corresponding periods in 1989 by May of 1990. However, the services provided by the airlines since the dispute are significantly different from those prior to the dispute. The airlines have now concentrated their main efforts on rebuilding capacity and restoring demand toward the more dense routes where demand has ensured the highest load factors. This is at the expense of some of the thinner routes such as Darwin - Mt Isa (4 000 passengers for the year to 30 June 1989) and Melbourne - Wynyard (64 000 passengers for the year to 30 June 1989) which have lost all domestic services since the dispute. Canberra - Sydney (600 000 passengers for the year to 30 June 1989), though not a thin route, to June had not regained the pre-dispute frequency of services it received for the corresponding time last year. The network changes instituted by the airlines are reflected in the updated table of the top 30 routes in Table 2, which covers the three month period to 30 June 1990. When compared to Table 1, it can be seen that airline activity has been concentrated considerably more on the top 30 routes since the dispute.

The main features of Table 2 are:

almost 47 percent of the total domestic traffic is concentrated on the top five routes, due to network changes which concentrate services on the more dense routes;

the top 30 routes accounted for approximately 88 percent of total domestic traffic, compared to 83 percent for the three months ending 30 June 1989;

the most significant change within the top 10 routes is the inclusion of the Hobart - Melbourne route, ranked ninth compared to twelfth in Table 1;

**TABLE 2: TOP 30 ROUTES SERVED BY DOMESTIC AIRLINES,  
FOR 3 MONTHS ENDING 30 JUNE 1990**

|                     | Route                  | Passengers       | Percentage<br>of total | Load<br>factor<br>(%) |
|---------------------|------------------------|------------------|------------------------|-----------------------|
| 1.                  | Melbourne-Sydney       | 606,537          | 19.0                   | 65.3                  |
| 2.                  | Brisbane-Sydney        | 395,255          | 12.4                   | 68                    |
| 3.                  | Adelaide-Melbourne     | 202,669          | 6.3                    | 77.6                  |
| 4.                  | Coolangatta-Sydney     | 148,987          | 4.7                    | 72.9                  |
| 5.                  | Canberra-Sydney        | 132,836          | 4.2                    | 69                    |
| <b>Total top 5</b>  |                        | <b>1,486,284</b> | <b>46.6</b>            |                       |
| 6.                  | Brisbane-Melbourne     | 132,015          | 4.1                    | 71.9                  |
| 7.                  | Adelaide-Sydney        | 120,780          | 3.8                    | 77.5                  |
| 8.                  | Canberra-Melbourne     | 111,595          | 3.5                    | 62.8                  |
| 9.                  | Hobart-Melbourne       | 101,067          | 3.2                    | 68.1                  |
| 10.                 | Brisbane-Townsville    | 91,539           | 2.9                    | 70.6                  |
| <b>Total top 10</b> |                        | <b>2,043,280</b> | <b>64.0</b>            |                       |
| 11.                 | Melbourne-Perth        | 88,872           | 2.8                    | 72.9                  |
| 12.                 | Launceston-Melbourne   | 70,426           | 2.2                    | 65.5                  |
| 13.                 | Brisbane-Cairns        | 69,803           | 2.2                    | 73                    |
| 14.                 | Perth-Sydney           | 60,789           | 1.9                    | 63.3                  |
| 15.                 | Adelaide-Perth         | 53,509           | 1.7                    | 64.9                  |
| 16.                 | Melbourne-Coolangatta  | 48,090           | 1.5                    | 71.1                  |
| 17.                 | Alice Springs-Darwin   | 42,006           | 1.3                    | 79.1                  |
| 18.                 | Adelaide-Alice Springs | 40,781           | 1.3                    | 82.9                  |
| 19.                 | Brisbane-Rockhampton   | 33,436           | 1.0                    | 61.1                  |
| 20.                 | Cairns-Townsville      | 31,368           | 1.0                    | 47.8                  |
| <b>Total top 20</b> |                        | <b>2,582,360</b> | <b>80.9</b>            |                       |
| 21.                 | Karratha-Perth         | 26,754           | 0.8                    | 77.2                  |
| 22.                 | Alice Springs-Sydney   | 24,616           | 0.8                    | 61.1                  |
| 23.                 | Coffs Harbour-Sydney   | 21,788           | 0.7                    | 64.9                  |
| 24.                 | Brisbane-Mackay        | 21,609           | 0.7                    | 66.7                  |
| 25.                 | Cairns-Sydney          | 21,218           | 0.7                    | 76.6                  |
| 26.                 | Brisbane-Darwin        | 20,869           | 0.7                    | 75.1                  |
| 27.                 | Devonport-Melbourne    | 20,300           | 0.6                    | 69.8                  |
| 28.                 | Kalgoorlie-Perth       | 18,918           | 0.6                    | 63                    |
| 29.                 | Sydney-Wagga           | 17,983           | 0.6                    | 69.9                  |
| 30.                 | Brisbane-Coolangatta   | 16,527           | 0.5                    | 39.8                  |
| <b>Total top 30</b> |                        | <b>2,792,942</b> | <b>87.5</b>            | <b>n.a</b>            |
| <b>Other Routes</b> |                        | <b>399,828</b>   | <b>12.5</b>            | <b>n.a</b>            |
| <b>TOTAL</b>        |                        | <b>3,192,770</b> | <b>100</b>             | <b>68.7</b>           |

Note: Passenger figures are traffic on board by stage which detail the aggregated (including transit) movement of revenue traffic from one airport to the next, regardless of the ticketed origin and destination.

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the relative rankings of the Brisbane - Cairns, Brisbane - Townsville and Cairns - Townsville routes are due to more direct services between Brisbane and Cairns and less indirect services via Townsville; and

a number of changes have taken place in the lower ranking routes of the top 30. The inclusion of Brisbane - Darwin (previously ranked 55th) and Brisbane - Mackay (previously ranked 61st) are due to significant network changes by the airlines. Likewise, the dropping out of the top 30, from Table 1, of Mackay - Rockhampton (now ranked 50th) and Hobart - Launceston (now ranked 73rd) are a result of the network changes which have resulted in decreased services on these routes which have traditionally had low load factors, as a result of them being an intermediate stage between a city pair that is now served directly.

*Opportunities for commuter operators:* The lack of air services on many routes during the early stages of rebuilding by the major airlines after the pilots' dispute, provided opportunities for commuter operators to provide services on routes from which they had previously been excluded. To some extent commuter operators have been able to continue services on additional routes, while others have been forced to withdraw as the major airlines reinstated their services

While only accounting for 9 percent of passengers carried on scheduled services, one major highlight for the commuter sector resulting from the pilots' dispute is the importance of feed from the major domestic routes for these operators. Anecdotal evidence suggests that, a number of commuter operators experienced significant declines in patronage even though this sector of the industry was not directly involved in the dispute. Some of the decline on commuter routes can be attributed to commuter operators reducing frequencies on regular routes in order to provide services on domestic routes. However the decline is mainly a direct result of loss of feed to commuters from the major carriers and on-carriage provisions for passengers to the major centres. Only incomplete data on commuter operations is currently available, however from this, the unevenness of the effects on commuter operators is reflected by the 65 percent decline in patronage for Western Australia commuter Goldfields Air Services due to fewer domestic services into Perth, compared to an 8 percent increase in patronage for NSW operator Hazelton Airlines, for the six month period after the pilots' dispute. Hazelton Airlines' traffic was boosted by its operations on additional routes following the pilots' dispute.

The end result of the dispute's impact on the commuter sector is that in most cases, the operations of commuter operators have returned to their pre-dispute status with little in the way of lasting new opportunities. The exceptions to this are Rottnest Airbus, Kendell Airlines and Eastern Airlines, which are all currently operating services from which they were excluded prior to the dispute. A more positive aspect is that a number of commuter operators did operate routes during the airline rebuilding and were

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able to get a feel for the markets that would be available to them after deregulation, and therefore gained longer term benefits.

### **Deregulation of domestic aviation**

The deregulation of domestic interstate aviation, on 31 October this year, will end 38 years of Government regulation of domestic aviation under what is currently known as the two-airline policy. Regulation under the two-airline policy reserved a set of major national routes for scheduled services to be operated by the Ansett Transport Industries group of airlines and Australian Airlines. These national routes, or trunk routes, are a defined set of routes which link some 18 trunk centres, including a number of larger population centres, as well as all the State capitals.

From 31 October, 1990 the definition of trunk routes, along with the legislation behind the two-airline policy will no longer apply under economic deregulation of domestic aviation. This will result in the removal of:

- .. controls over the importation of aircraft;
- .. the restriction on capacity that the major airlines, Ansett, Australian and East-West, can provide on their route networks;
- .. the IAFIC's control of air fares; and
- .. the constraints on the entry of new interstate operators to trunk routes.

### **The incumbent operators**

Since the pilots' dispute, Ansett and Australian Airlines have used the lead time to deregulation to broaden their market access and to improve their public profile and corporate image in order to place them in the best possible position for the competitive environment after deregulation commences.

*Airline alliances:* The purchase of East-West by TNT/News Corporation in 1987, as well as giving Ansett access to a no-frills airline, has essentially eliminated an established competitor for it to contend with after deregulation. The airlines have also set up equity and commercial links with commuter operators, giving the major airlines access to small markets that could not be served economically by the larger airlines. These alliances usually include oncarriage, reservations and provision of ground

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handling arrangements. Within the major airlines and their relative alliances, strong corporate image is apparent in the lead up to deregulation, with the change of name for Air NSW to Ansett NSW and the change to Australian Airlines' colours for commuter operators Eastern Airlines and Sunstate Airlines.

*Re-equipment plans by the airlines:* Over the last two years, re-equipment of aircraft fleets has been undertaken by the domestic airlines and some commuter airlines:

Ansett have introduced Airbus A320 aircraft to its fleet;

Australian's recent strategy has been to introduce Boeing 737-400 aircraft into its fleet after earlier planning to acquire Airbus A320s;

The pilots' dispute was responsible for East-West bringing forward its plans to drop its F27 aircraft from its fleet. In September last year East-West dropped the F27 aircraft from its fleet in order to prepare for the delivery later this year of new British Aerospace 146 aircraft which it will eventually use to replace its current F28s which will be phased out over the next two to three years; and

Commuter operators, Airlines of Tasmania and Eastern Airlines have recently taken delivery of new generation aircraft - and intend to introduce more as they become available.

During rebuilding after the pilots' dispute, Ansett closed down its Fokker base in Melbourne. Ansett had used its F50s on its services to the north coast of Tasmania and attributed the pilots dispute for "irreversible damage" to these services (The Australian 1989). However, the Fokker aircraft were never really successful on these routes and it may have been more that it was a convenient time to close down the Fokker base so that Ansett could concentrate more on its thicker routes, than the dispute leading to its closure.

*Enhancement of passenger services:* In the lead up to deregulation Ansett and Australian have undertaken to upgrade and expand their airport facilities at the major airports. Ansett has begun to expand its terminal at Melbourne Airport which will increase its aircraft parking capabilities for large aircraft from 10 to 18 by November. The work is part of a national programme to upgrade airport facilities. Work is also underway at Perth, Darwin, and Hamilton Island, and work is complete at Brisbane. Australian Airlines has established a conference centre at Melbourne Airport and plan to build one at Sydney, as part of its strategy to attract the business market.

Both Australian Airlines and Ansett are enhancing the service provided to travellers by delivering their luggage to hotels. Australian is offering its first and

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business-class passengers the opportunity to upgrade their accommodation to better rooms in selected hotels. Ansett has introduced "self-write tickets", which are booklets of blank ticket forms for travellers who operate an account with the Airline. Ansett has also introduced a service allowing passengers to complete hotel registrations at the airports.

In the leisure market, Australian Airlines is placing increased emphasis on its packaging of holidays to allow increased flexibility. Accommodation packages are able to be coupled with advance booking discounts on flights, which range up to 45 percent. They have also introduced a range of two-for-one offers on holiday activities which are available to holders of special cards.

Ansett's strategy in the leisure market has been to negotiate exclusive deals with hotels and resorts for its holiday packages. Ansett is also offering prizes in the form of free travel and chances to win mystery weekends of travel and accommodation to lure customers.

*Fare initiatives and yield management* The incumbent airlines have always offered a comprehensive range of discount fares. This year, Ansett and Australian introduced a new dimension to fare discounting in Australia, based on computerised yield management systems. The airlines are able to identify off peak flights and the bookings that are made on these over a period of time to develop a booking pattern for individual flights by time of day. This allows the airlines to offer discount fares on nominated flights before the flights are booked and provides them increased revenue due to the sale of seats which otherwise would not be booked by passengers at the normal fares.

The results of research undertaken by the Bureau of Tourism Research indicates that leisure oriented trips account for almost 52 percent of trips of more than one day duration and involving air as the main mode of transport. While leisure travel is largely income driven, the size of this sector of the market would suggest that the increased use of discount fares by the airlines to encourage travellers is still a sound business strategy, particularly where such fares are used on a revenue 'top up' basis.

### *New entrants*

Expressions of interest have been lodged by several potential new operators in the domestic airline industry after deregulation commences. The intention to operate extensive interstate route networks have been announced by four new operators to date. These are Compass Airlines, Capitol Airlines, Southern Cross Airlines and Trans Continental Airlines.

In addition to the expressions of interest from the four main potential operators, a number of others have expressed their intention to commence services, including Air Hibiscus, Sea Board Airlines and some commuters who want to expand their networks to include some new routes from which they are currently excluded.

*Compass Airlines:* Compass Airlines is the most advanced of any of the possible new entrants in its preparations to operate after deregulation. The Airline released its prospectus in May this year, and was successful in raising \$65 million equity through the issue of public shares. Compass, which is proposed to be based in Brisbane, expects to take delivery of the first two of five Airbus A300 aircraft in March 1991 and the other three about two years later. In the intervening time between commencing services and the arrival of its aircraft, Compass will lease two aircraft from British airline Monarch. The route network that Compass proposes to operate includes Sydney, Melbourne, Brisbane, Adelaide, Cairns, Perth and Coolangatta.

*Trans Continental Airlines:* Trans Continental Airlines has been established by former pilots of Ansett and Ipec. The Airline intends to base its operations in Melbourne and operate nationally with a fleet of twelve Boeing 737-300 aircraft.

*Southern Cross Airlines:* Southern Cross Airlines has been established by former senior executives of Australian Airlines. The Airline has announced that it will operate from either Brisbane or Melbourne and serve all the main cities. Southern Cross also intends to use McDonnell Douglas MD-83 aircraft for its operations (The Australian 1990).

*Capitol Airlines:* Capitol Airlines, also proposes to base itself in Brisbane and plans to operate a similar route network to Compass, concentrating on the eastern ports. Capitol will include Townsville in its network in addition to the ports that Compass proposes to serve, but will not fly to Perth. The Airline plans to lease eight McDonnell Douglas MD-83 jets.

There is still some doubt over whether Capitol will start operations in Australia after deregulation, as press reports indicate that the management is also reviewing other options available to them to help set up airlines in South-East Asia. The Airline has deferred its planned launch for at least six months, and suggested it might even discontinue its plans to fly in Australia (Financial Review 1990).

*Domestic Terminal access:* On 22 May 1990, Compass Airlines and Trans Continental Airlines were awarded priority ranking for access to terminal facilities at each of the relevant airports, except Launceston, where Trans Continental was awarded first priority. Southern Cross Airlines was awarded third priority at Sydney and Melbourne airports and intends to make alternative arrangements with the Federal Airports Corporation (FAC) for terminal access at the other ports it intends to serve. Capitol Airlines was awarded third priority for terminal facilities at Adelaide, Perth and Coolangatta; and fourth priority at Sydney and Melbourne.

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Compass has announced that it will use Australian Airlines' facilities where it is unable to provide its own, while Trans Continental seeks to use Ansetts' facilities at the ports where it was awarded priority.

#### Growth forecasts

As far as growth forecasts of domestic passenger demand are concerned, very little work has been undertaken in recent years that explicitly takes into account the effects of deregulation. The most recently published forecasts are those undertaken for the Federal Airports Corporation, released in March 1990. The forecasts are based on the assumption that the pilots' dispute will not have any lasting effect on long-term demand. The forecasts provide for average annual growth of 3.5 percent for the 20 year period up to 2008 (FAC 1990).

*Determinants of passenger growth:* The airlines have at their disposal two primary approaches to stimulate passenger demand. These are through the fares that they offer and the quality of service (including frequency) that they provide.

Research undertaken by the BTCE several years ago and based on a small segment of the market has suggested that passengers are relatively insensitive to changes in air fares overall, but certain segments of the market are sensitive to changes in air fares (BTCE 1985). The more recent study undertaken for the FAC has predicted that air fare reductions will not be sustainable beyond the short term (FAC, 1990). The FAC's scenarios provide two possibilities; an initial 10 percent across-the-board decline in real air fares followed by possible further declines of 5 percent in 1992 and 1993 and then to remain constant in real terms, or that fares will not be reduced and will continue to rise in real terms as real costs increase.

If unable to maintain reductions in real air fares beyond the short term, the airlines may choose to compete on service quality options available to them. Competition is likely to occur in frequencies and attractiveness of services, for example direct flights versus indirect flights. The current fare formula used by the IAFC to determine fares to be charged by the airlines gives higher revenue from multi-stop services due to the flag fall component of the formula. Thus this discourages direct flights, although these are preferred by the consumers. The airlines have already instituted network changes with more direct flights, as outlined earlier in this paper, which, under the current fare structure imposed by the IAFC, may result in reduced revenue in the very short term, but with gains to be made thereafter. With the new network structures in place now, the incumbent airlines will be in a position to introduce new fare structures upon deregulation which are more in line with these networks.



## Conclusions

The changes that have occurred in the domestic aviation industry over the last 18 months have set the scene for a challenging time after deregulation of the industry on 31 October 1990. The major outcomes that can be expected from deregulation are that the industry will gain at least one new major operator by the end of 1990, in Compass Airlines, and the industry should be more competitive. The main area from which competition will arise, aside from Compass' entry, will be from the fact that Ansett Airlines' and Australian Airlines' ability to control supply of capacity on major routes and price, will disappear; and East-West will enter the new era with a much more competitive aircraft fleet, with the introduction of its BAe 146 aircraft.

With the slowing down of the Australian economy during 1990, it might be expected that any new operators would find it difficult to establish themselves as competitors as the airline industry enters a new era of competition at a time when the market for air travel may be depressed. It is well known from Australian and overseas experience that a major effect on passenger demand is the state of the economy, however experience in the US and Canada have shown the effects of the economy on new operators to be somewhat surprising. In the early stages of deregulation in the US, the economy was in the midst of a downturn. The effect of this was that new operators with lower cost structures did very well in the depressed market. It was not until after the economy recovered that many of the new operators found the going tough. Conversely, when deregulation commenced in Canada, the economy was in a state of growth, and it was the new entrant Ward Air which had embarked on an aggressive price cutting strategy whose bid ended in its amalgamation with Canadian. These examples serve to show that it is not clear cut that a slowing in the economy will necessarily adversely effect any new operators in the early stages of deregulation, particularly if, as Compass claims, they have lower cost structures than the incumbent airlines.

While initial support for the new airlines will be partly out of curiosity by travellers to compare them to the incumbent airlines, overseas experience with deregulation suggests that their continued success may be largely determined by their strategic choices in the quality of service provided to the business traveller as well as the offer of cheaper fares to the discretionary leisure traveller.

The rebuilding of the incumbent airlines after the pilots' dispute has given them the opportunity to restructure their route networks and schedules in preparation for new fare strategies that they will introduce after deregulation. Over the last six months to deregulation, the incumbent airlines have been able to test out their new network structures on the travelling public and should commence the deregulated environment with finely tuned networks. This, together with new yield management techniques that have been introduced by the airlines should enable them to be competitive with the new airlines.

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The impact that deregulation will have on the commuter sector is another largely unknown quantity. These operators are expected to become more important on interstate routes as they will be able to fill in the scheduling gaps during the off-peak times, when it is less profitable for the major airlines to operate jet services. Some of the commuter airlines experienced operations on some of the routes to which they will have access, during the early stages of airline rebuilding after the pilots' dispute. In terms of current benefits to these operators from the services they provided during the airlines' rebuilding, very little has been gained. However these operators did have the opportunity to test out some new markets for a short time after the dispute and no doubt would have noted the experience for future reference after deregulation commences.

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