

Analysis of Airport and Airline Relationship

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Table of Contents

Abstract.....	3
Introduction.....	3
Brief History of the Relationship between Airports and Airlines.....	4
How Should Airports Attract Airlines? - Cost Support May NOT be the Only Way -.....	6
National Airlines and Foreign Airlines.....	8
The Role of Airports in Stimulating Demand.....	9
Airports as “a Connector”.....	10
What Airports Need to Pay Attention to.....	12
Conclusion.....	13
Reference.....	14

## Abstract

Airports and airlines are entities which share a common goal. At the same time, we are in a relationship of service suppliers – customers. As time passes, the relationship has changed. Airports were much superior, but gradually the balance has shifted to airlines by the enforcement of deregulations. Especially airports, except for larger ones which usually have limited access of slots, often face a risk of air routes being suspended immediately if the performance is not favorable.

In order for airports to maintain or expand airline routes, it is true that support for airport costs is an effective way, but the most important thing is to generate travel demand continuously. In terms of network expansion at airports, it is essential to attract foreign airlines which do not have their base in that country as well as national flag carriers. However, these carriers often have little knowledge of the market outside their own country or have little marketing clout. Therefore, airports need to become their connector and to be able to connect airlines with other related industries in own country/region. It is important to cooperate with various industries so as to solve problems which each airline company has and produce demand they want.

There are several things to bear in mind when airports deepen a partnership with air carriers. Airports are required to provide each company with a fair business environment, so we need to avoid concentrating on a certain company although there are a lot of airlines in the world. We must also remember that an airport and an airline are different entities. Consequently, both have to pay attention not to violate applicable laws or treaties through their cooperation. In addition, in order to have a stronger partnership we also have to raise or employ personnel who understand their business practice, ways of thinking and languages etc. It is time for airports to make every effort to increase demand in a variety of ways with the cooperation of airlines.

## Introduction

An airport is a “device” to encourage the movement of people and goods by using aircraft. Particularly, the role of international airports has been getting larger and larger amidst the tide of globalization because they connect one country to other countries. It is essential for a local economy or even a country itself to have an airport which has an extensive network.

In this situation, nobody denies that airlines are important partners for airports. Passengers come to the airport since they can catch a plane there. Tenants set up shops in the terminals and are able to sell products because customers gather there. First of all, airport business starts when aircraft fly in and out of the airport. To expand its revenue, an airport must first and foremost ensure it has flights. An airport with no airline service would be nothing more than an empty plaza.

On the other hand, airports are indispensable partners for airlines. Planes are not able to fly without a runway. Air carriers cannot transport their passengers if there are no handling facilities. They need cargo handling facilities, too. Because airline companies do their business in other countries, it is practically impossible that a carrier can prepare all of the facilities needed in the same way that railway companies do. They need airports to run their business.

Airports and airlines share a common goal in doing their respective business. That is to earn revenue from money paid by passengers. However, there is also a different side to the relationship between the two parties. Airline companies want to pay as little as possible in charges to airports to reduce their own cost. On the contrary, airports are not able to set too low prices because airport operators gain money not only from passengers, but from aircraft operators as facility charges such as landing fees. The relationship of the two entities is complicated and difficult because both have things to share but also have conflicting interests.

This research paper discusses the history of the relationship between airports and airlines. Then, it also discusses what relationship airports and airlines should have so that they can work together for mutual benefit, particularly focusing on the interaction with foreign airlines.

#### Brief History of the Relationship between Airports and Airlines

The relationship between airports and airlines has been drastically changed over the decades. For a few decades after the end of World War II, airports and airlines were protected by the designation of airlines that were permitted to operate and restrictions on establishment of routes pursuant to government authorization. Under these restrictions, both parties formed part of an implicit contract where an airline accepted facility charges which an airport presented in advance with terms and conditions of airport use once it began its operation at the airport. (Starkie) Therefore, with regard to the relationship between the two organizations it is just like an owner-tenant relationship in which an airline pays charges to an airport according to the terms and conditions. They did not need to interact with one another any further because there was no room for the two parties negotiating charges due to airline regulations. However, a major transition occurred in the aviation industry in the 1970s. This is the so-called deregulation (also known as airline liberalization). Due to deregulation of the airline industry in the United States, airlines were given the freedom to set up and abolish services as they wished. In other words, air carriers were granted “the right to choose airports.” Similar regulatory relaxation spread across other parts of the world such as the European Union, Asian and Latin American countries with the tide of economic globalization. (Smith & Cox) Thus, it ended up that airports as well as airlines were exposed to severe world competition.

Deregulation is a major threat to airports, for airlines, which had until then paid airports a fixed price for charges, have an opportunity of negotiation with airport operators on maintenance or expansion

of air routes. For example, when an airline plans to launch a new service, the carrier is now able to weigh several airports in order to extract discounts on facility charges. Airports want airlines to operate as many flights as possible and need to attract their passengers so as to increase their revenue and profit. Therefore, to attract airline companies, airport operators now have to provide them with an incentive so that they can compete with other rival airports. To cope with the situation, some airports decided to give a landing fee discount to airlines which operate the new service and other airports started to rebate passenger facility charge (known as PFC) for any additional volume of passengers carried by airlines. Furthermore, because airlines can freely end their unprofitable flight services, now airport operators also have to spend their budgets for marketing activities to maintain airline services or to boost travel demand in case the service should be abolished and the number of passengers should decrease.

These activities require funding which must be derived by either expanding sales or streamlining airport operations and cutting operation costs. Now airports have to make efforts of their own to survive this competition.

As a consequence, deregulation has suddenly weakened the airport's position. This is the reason why it is said that *airports are victims of airline deregulation*.

On the other hand, the deregulation created new opportunities. Deregulation has also bestowed the freedom to establish new airline companies, and in particular, led to the emergence of low cost carriers (LCCs). LCCs are able to earn a profit on a route that traditional full service carriers (FSCs) were unable to by cutting all types of cost, keeping their fare continuously low and creating demand. Therefore, a lot of airports strive to attract LCCs to restore routes that FSCs have either reduced or pulled out of due to skyrocketing fuel prices or economic downturns.

These are the trends of the aviation industry and the change in airports' relationship with airlines over the past few decades. As a result of deregulation, airports have changed their business model from one where profit is gained from money airlines pay, to the model where profits are generated from revenue from passengers, which are returned to air carriers as the reduction of the charges, which then can lead to route expansion. This also means that airport industry is now shifting their idea from "dual till" approach which breaks airport business into the aeronautical part and non-aeronautical one and aeronautical expenditure such as runway maintenance cost covered by income from the aeronautical side of the business such as landing fees and the non-aeronautical income to provide for non-aeronautical expenditure, to "single till" system whereby all revenues of an airport are directly considered for setting airport charges to make a profit as a whole, although "single till" model may not be an ideal way for airports because airports will be dependent heavily on non-aeronautical revenues to meet their targeted returns. (ACI 2)

However, only with a shift to the approach towards costs, it is fairly doubtful that airports can keep growing in the future. As stated above, airlines and airports are customers and service providers because airlines pay money to airports for the use of them, but at this point it must be remembered that

both companies obtain revenue by attracting passengers and freight to each facility. Both need people or things to carry, so both parties should be able to cooperate with each other in terms of stimulating demand.

Particularly, in the face of greater selection and concentration within the industry, fewer airports have what it takes to become airline hubs. At the same time, more airlines are forming alliances and it has become possible for airports to expand their networks even if they are not used as a hub by a particular airline. In these prevailing circumstances, there must be more that airports can do to attract different airlines and routes than merely reducing or exempting facility charges.

#### How Should Airports Attract Airlines? – Cost Support May NOT be the Only Way –

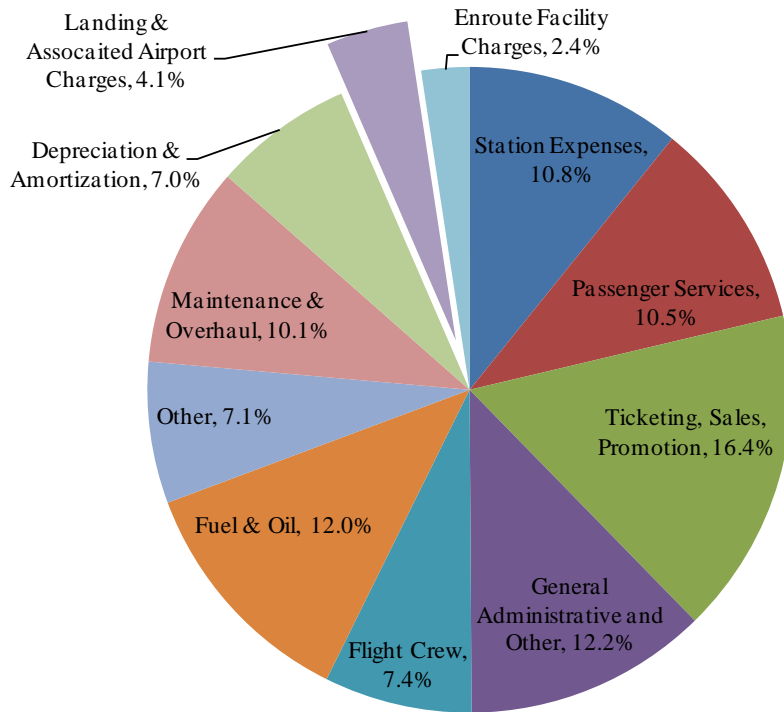
Of course, offering landing fee discounts, etc. is an effective way for airports to attract and assist airlines and we need to make efforts to reduce all types of cost to keep the airports competitive, but there seems to be a limit to it.

First of all, we need to understand that the airline business entails extremely high fixed costs. There are many types of expenses that are not easily reduced such as maintenance fees, personnel expenses, fuel costs etc. In this situation, it is no wonder that they try to choose airports which provide access with less facility charges. Yet, the share of airport charges in airline costs is, as shown in *Figure 1*, only from 4% to 5%. (ICAO) The data in *Figure 1* is a little old and it may not account for unprecedented fuel price hikes, but data from Airlines for America (formerly known as Air Transport Association of America) also shows that landing fees make up as little as 2% while fuel and labor costs make up about 55% of overall costs. (Airlines for America) Rent of airport facilities are included in “Non-Aircraft Rents & Ownership” section, but the percentage is still around 5%.

Also, the percentage of airport facility charges of all costs has been almost the same since deregulation was enforced in US in 1970s according to *Figure 2*. (ACI 1) Even if all airport charges were exempted, it is not hard to imagine that a service would be suspended when it cannot make money to cover other 95% of the operational cost.

To take up one example, Kansai International Airport (KIX) faced a crisis as the network for North America greatly shrank between 2006 and 2009. Indeed, at KIX some flights for US inaugurated in 2004 and 2005 such as United’s Osaka Kansai – Chicago O’Hare in 2004 and American’s Osaka Kansai – Dallas/Fort Worth in 2005. One of the factors behind the launch of these services was the incentives and landing fee discounts offered by the airport as well as the assistance of the local municipal governments and businesses. However, these services ended up being suspended. This example illustrates vividly the fact that a service can subsist only if it has demand and not by way of cost support alone.

Figure 1 Breakdown of Airline Operational Costs



Source: The Aviation & Aerospace Almanac, ICAO Air Transport Reporting Form EF-1

Figure 2 Airline Charges as a Percentage of Airline Operating Costs

Year	Percentage
1978	4.0%
1989	3.7%
1998	4.4%
1999	4.4%
2000	4.2%
2001	4.0%
2002	4.0%
2003	4.0%
2004	4.0%
2005	3.8%

Source: *The Airport Business*, ACI position brief October 2007

There is another issue that is difficult to find a solution to. There are various restrictions when discounting the facility charges in order to convince airlines to open up new routes. Article 15 of ICAO's

*Convention on International Air Transport*, also known as, Chicago Convention addresses airport charges as follows.

“Every airport in a contracting State which is open to public use by its national aircraft shall likewise, subject to the provisions of Article 68, be open under uniform conditions to the aircraft of all the other contracting States.” (8)

In short, what this sentence tells is that airport charges should be under the same condition for all airlines. In other words, airports cannot give special favorable treatment of cost to airlines or air routes which airports want to attract. Moreover, *ICAO’s Policies on Charges for Airports and Air Navigation Services* also recommends that landing charges should not be discriminated depending on flight length flown. (ii-3) For example, it would be against the recommendation if an airport provided substantial discounts for long-haul flights so as to attract these kinds of services.

Anyway, airports cannot offer cost-related preferential conditions to specific airlines. Such conditions, therefore, cannot be used to attract needed services. However, if airports provide huge discounts to all of the airlines, it will lead to a drop in revenue and could even end up jeopardizing the airport’s business itself. In general taking this into account, as stated again and again, there is a limit to maintaining or expanding air network simply by offering reduction of airport charges. Then, what can be done except for providing discounts of charges so as to help airlines keep or expand their services and to develop the airports’ network?

#### National Airlines and Foreign Airlines

Broadly speaking, airlines are divided roughly into two types; national airlines which have their base in the country of the airport and foreign airlines. The characteristics of these two types are vastly different as described in *Table 1*.

*Table 1* Differences between National Airlines and Foreign Airlines

	National Airlines	Foreign Airlines
Understanding of the Market	Good understanding	Poor understanding
Recognition in the Market	Well-known	Not Well-known
Sales Channels	Extensive network	Need to be developed
Capital Investment	Large	Relatively small

Source: Own illustration



National airlines are naturally more familiar with the market characteristics of the country and have higher public recognition. In the ways of sales, they have an extensive network in every direction and also have abundant channels to sell tickets or products. Since airlines set up their base in their home country, they also tend to make large investment in the airports. Due to their large investment to the airport facilities, it is unlikely that they would withdraw from the airports in the country.

Consequently, national airlines are capable of undertaking their own sales activities and there is only so much airports can do to encourage them to introduce new services. If anything, the main type of support that airports can give national carriers is to help them reduce costs.

On the other hand, this is not the case with foreign airlines. Of course, in their own countries, these carriers would have an established presence and would be well acquainted with the market conditions and marketing methods. However, at their countries of destination, they would need to cultivate sales channels from scratch and there would be much they would not know about local market characteristics and business practices. Furthermore, since they do not have high public recognition, consumers may not even notice that they had launched a service. Besides, as in the earlier example of US airlines pulling out of KIX, foreign airlines would quickly decide to suspend or withdraw their flights if they do not have sufficient demand to operate a service, because they tend not to invest in the airports outside their own country. That is the reason why it is getting more and more important for airports to cooperate with airlines to try to stimulate demand. It is obvious for people who have been or were working on route development at an airport that it is really difficult to persuade airlines to resume their abolished flights or restart a suspended route. Even if only airports make an effort to create demand, the effect may be limited, but airports are regarded as important infrastructures for the region of the country. Considering this fact, airports also seem to have lots of other reliable partners.

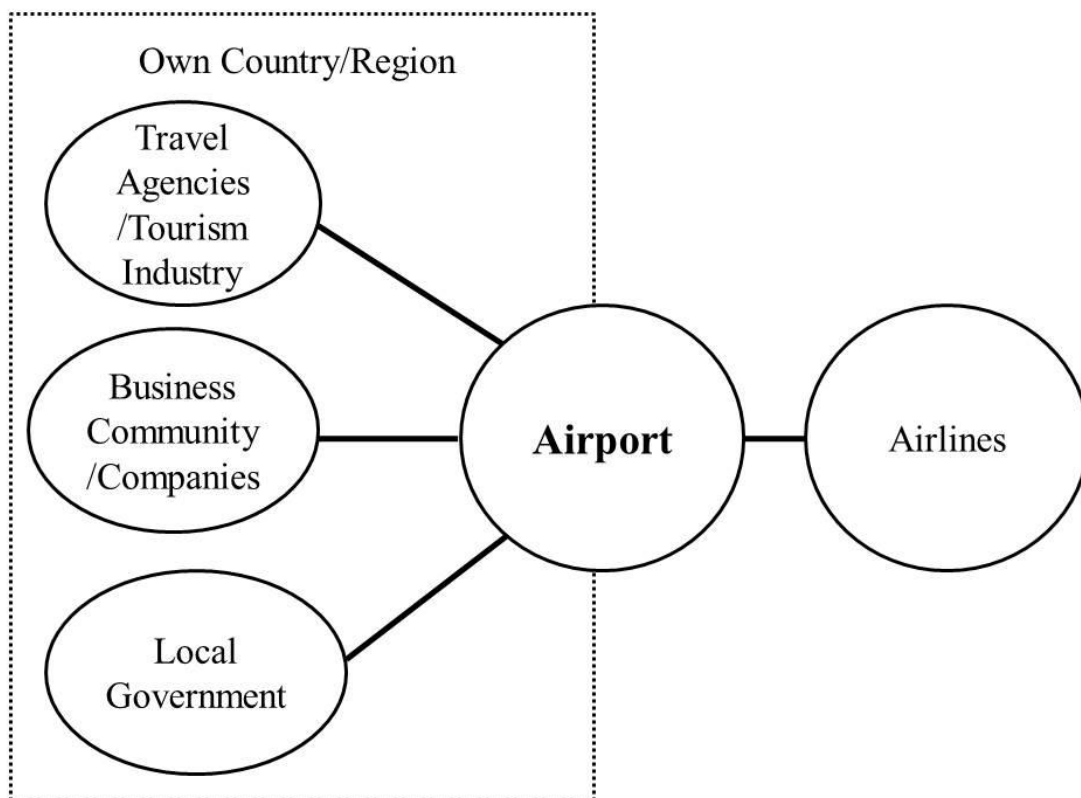
#### The Role of Airports in Stimulating Demand

Airports are often considered a driving force of the local economy, so airports are of interest to local government and business communities and airport operators usually have a strong cooperative network with them. It is widely recognized that they need airports in order to gather people, goods and money from all over the world to the region and activate the economy since airports are connected to other areas of the world. Therefore, the fact that an airport is served by many airlines operating a wide array of services is important to everyone in the region and great hopes are placed on the airport itself.

However, it is also difficult for airlines which do not have a base in the country to develop their market on their own. As a result, if they cannot get expected performance and their head office decides to suspend or withdraw the service, it is a significant loss not only for the airlines and airports, but the region or the country as a whole.

In thinking this way, there seems to be one possible solution. Airports can play a role in connecting the airlines to various organizations of the regions. Airport operators have a network for local organizations as well as airlines. Then, this will be a help for the airlines to develop demand. Consequently, this idea will bring about benefits for airlines, regional organizations and the country, as well as airports.

Figure 3 Network of Airports, Airlines and Other Related Industries



Source: Own illustration

Airports as “a Connector”

In fact, there are several types of airlines. For instance, some put much more value on revenues generated from premium class while others are operating mainly short-haul high-frequency services like LCCs. Of course, each company has their unique problems and ways of approaching them differ accordingly.

Airlines operating, in particular, long-haul flights, whose carriers are mostly FSCs, consider it important to capture premium class demand. Main users of premium class are businesspersons on

business trips rather than general tourists. However, local business communities are the last groups that foreign airlines can reach. From my experience in dealing with them, the most difficult thing, they said, was for them to build a network in the business circles. A city of reasonable size would have a large number of firms in the area, but it is extremely hard for foreign carriers to approach those firms unlike national airlines which have many employees. For foreign airline staff, just meeting business persons seems to be a challenge in itself. Usually, airlines conclude special contracts that promise to provide them with favorable treatment, such as offering the right to use their lounges, upgrade of the seat class or more reasonable fares, but it appears that in many cases, foreign airlines find it difficult even to organize a meeting with the company personnel in charge of arranging business trips. In these cases, it is when airport operators who have a network of business circles come in.

As for LCCs, they sell their tickets through the Internet and try to be independent of travel agencies. However, in some cases this business model does not work well mainly in East Asia because airline tickets are mainly sold through travel agencies in that area. Therefore, airports can provide them with market information on its characteristics or give them advice on how to improve ticket sales. Also, airports can introduce local travel organizations to carriers because the organizations know the market very well and can make good suggestions to them.

What can be done in the passenger services is applicable to cargo business, too. For example, Kansai Airport now has a project called “Creating Cargo.” This is a project in which the airport serves as an intermediary in exporting goods that had not been transported overseas by airplanes before. These days the high quality of fruits and food produced in Japan is drawing the attention of people and has caused a demand for fresh Japanese food. Focusing on this trend, the airport created ties among manufacturers of food, trading companies and airlines and organized a business conference overseas with the objective of expanding exports. This event was held with the support of airlines as well as business communities in the Kansai area and ended in great success. On another occasion, KIX held a seminar called “KIX AIR CARGO MEETING” where the airport gathered airlines, shippers and freight forwarders, etc. in one place to maintain close communication and all of the related parties tried to expand demand of export by using air transport. As a result of these activities, this year KIX received first place of the Air Cargo Excellence Survey – the annual award by the air cargo magazine *Air Cargo World* of UK’s UBM Aviation – in the category of Asia airports handling amounts of cargo from 400,000t and 999,999t. KIX won the award 2 years in a row and 5 times since the award first started. FedEx also appreciates airport’s efforts and has decided to make their North Pacific Regional Hub at Kansai International Airport.

## What Airports Need to Pay Attention to

It is all well and good to consider the potential of airports which may become a connector of airlines and the other industries in its own region or country, but becoming a connector means that an airport will be encouraging people to use flights by a particular airline and that it will be heavily involved in the core business of the airlines. At this point there are some things that airports have to keep in mind. That is, airport operators must not get engaged in airlines excessively, especially in one company.

No matter how important a particular airline or service is compared to the rest, giving preference to specific airlines will raise ethical issues and, in some cases, may become liable for legal action due to obstruction of business. For example, if a certain airport were in need of a service to London for strategic reasons, it would probably offer an airline that will operate this service special conditions on airport charges and various other forms of assistance to maintain and expand the service. This is understandable because the airport will acquire a service it requires strategically. However, due to the nature of the airline industry, passengers could just as well fly to London via another airport, and from the perspective of European airlines that had been catering to this demand, the airport would end up wresting away customers from them. Therefore, to ensure impartiality, an airport will have to establish a transparent set of rules for assistance that is standardized to a certain degree.

Another item of consideration is to what extent the airport should get involved in the operations of individual airlines. If it gets into their business too deep, it may be suspected of a violation of antitrust law or similar laws. For instance, AIR FRANCE and KLM made a manual about competition law compliance for employees of the companies in order to prevent them from violating the law and it suggests how to deal with the situations where they meet competitors or people in the industry. In cases like this, the airport must pay full regard to the situations of the other party in carrying out activities.

In addition, when the activities are successful, the more network of the airport will expand, the more airlines will fly into. At the time, each company has a unique problem, so the ways to approach airlines will also vary. To make an effective approach adequately, airports should develop or secure personnel who know airlines' way of thinking and are familiar to the country of the carriers. Especially, from a strategic standpoint employees who understand the local language are important in attracting foreign airlines. Moreover, it may be another possible solution that airports should actively encourage their employees to attend training courses held by ACI or IATA or other industry organizations.

In short, airlines are not all the same, so there may be some problems that airports cannot solve. What is important is to have a clear understanding of situations of each airline, to think from the airlines' standpoint and provides airlines with the best possible support.

## Conclusion

In recent decades, the relationship between airports and airlines has changed dramatically. Further deregulation will no doubt transform the aviation industry itself even more. Amidst these changes, this paper pointed out the importance of stimulating demand in addition to discounting airport charges in order for airports to gain the trust of airlines and secure an extensive network of air routes. When I was in the Route Development section of Kansai International Airport (which is officially called Aviation Sales & Marketing Department) and worked together with people in foreign airlines, I felt that the airlines were limited in what they can do to approach customers and that they needed help in expanding sales to maintain and augment their services. It is as a result of thinking over what airports can do to solve the problems that I decided to focus on airports' role as "a connector" by making use of their network in this paper.

As mentioned above, the aviation industry is highly involved in the development of regional or state economies. The industry will undoubtedly continue to face major changes and challenges in the future. However, many of the issues will be overcome if airports and airlines work together with local or national industries. For airlines and airports to enjoy many more years of prosperity, they need to cooperate for mutual benefits. The activity for creating demand is not easy and it is hard to evaluate the effect, but both parties are asked to think of their own *raison d'être* of transportation of passengers and goods and to cooperate with one another. If airports actively work as "a connector," which supports industries including airlines, airports will receive a good reputation and as a result it will lead to airport's growth. Unlike railway companies, an airport and an airline are separate entities, so there are various barriers against cooperation between the two parties, but it can be successful by exchanging ideas. To achieve this, airports must seek to understand the airlines.

The time is long gone when airports and airlines could acquire customers and make profits without any effort. For future development, airports must boldly join hands with airlines to drive forward initiatives to stimulate demand.

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