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Hubs versus Airport Dominance

This study separates what is known in the literature as the airport dominance effect (dominant airline's ability to charge higher fares for trips to/from the airport at which it has the dominant position) into what can be interpreted as quality and market power based components, using price data for trips to/from/through five US airports, each serving as a hub for two US carriers. The authors find market power based component of the dominance premium is smaller than the quality based one. They also determine that dominant carriers exercise their market power on an average customer rather than a price insensitive business traveler. This is in contrast to what previous studies suggested..

In the literature airport dominance is expected to be a far more important source of market power than route dominance. The airlines' frequent flyer programs appears to be the most plausible explanation for this.

The authors however argue that the airport dominance effect may not only be the reflection of market power but also the higher quality of the product offered by the dominant carrier. Disentangling the contribution of both sources to the airport dominance effect is important, since only the first source may give reason to action by regulators. If however the fare premium can partly be explained by the customers' valuation of the carrier's frequent flyer program and access to an extensive network of non-stop flights out of the hub airport, then airlines are utilizing a 'quality-based' approach to pricing.

The authors conclude that the average traveler pays for the 'market power based' airport dominance premium, whereas the price-insensitive business traveler pays an equal premium for traveling to/from the hub, irrespective of the question whether the carrier has a dominant position or not. Apparently non-dominant carriers at a hub are still able to charge a quality-based hub premium.

From the regulators point of view the separation of these two premium effects at the hub is an important result of this study.

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