

Supplementary evidence on the importance of the Alliance to competition for corporate and high frequency travellers in Australia and on the Tasman

Executive Summary

Virgin Australia has submitted that:

- Absent the Alliance, Virgin Australia will not grow capacity on the Tasman and will be required to withdraw capacity and services on some routes in accordance with commercial business performance. As a result, Virgin Australia firmly believes consumers will be worse off absent the Alliance.
- Virgin Australia's Game Change Program brings much needed competition for domestic and international travel to the dominant position of the Qantas Group in the provision of services to corporate/government and frequent travellers.
- The Alliance is critical to enabling Virgin Australia to have an offer that can effectively constrain Qantas/Jetstar/Emirates Alliance (**Qantas Alliance**) in the provision of services to corporate/government travellers and high frequency travellers in the region.
- No matter how good Virgin Australia's domestic product is, it will always face limitations in attracting corporate accounts and high frequency travellers away from the Qantas Group (now part of the Qantas Alliance) if it cannot offer a competitive international network with destinations, frequencies and enhanced product offering (including loyalty program and lounges) all of which attract such passengers. This is true whether or not domestic and international air services are being purchased from a single provider. The only economically feasible way for Virgin Australia to match the Qantas Group offer is to create an integrated international network through alliances.
- A competitive trans-Tasman offering is crucial to winning and retaining Australian corporate/government accounts and the business of high frequency travellers.
- Without the Alliance, Virgin Australia will not have an offering that can effectively compete with the Qantas Alliance on the Tasman or for corporate/government accounts or the business of high frequency travellers. This will result in less effective choice for consumers and less competition in domestic Australia and on the Tasman. This is discussed further in **Section 1.3**.

ACCC request:

The ACCC has asked Virgin Australia to provide supplementary evidence in relation to the above. In response, the following documents are enclosed:

- **Evidence of corporate tenders:** [**CONFIDENTIAL**].
- **Route profitability analysis:** an analysis of route profitability based on data including Virgin Australia's Profit Before Tax

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(PBT) for FY2013 and indirect benefits derived from the Alliance.

- **Other quantitative evidence:** including comparative tables, diagrams and surveys.

An index of the above documents is provided at **Confidential Annexure A**.

Contact details for corporate clients and Travel Agencies :

As requested, Virgin Australia has also provided contact details for the following corporate clients and Travel Agencies should the Commission wish to contact them to provide further information on the significance of the Alliance and Virgin Australia's ability to offer a competitive Tasman operation to these corporate clients:

- **[CONFIDENTIAL]**.

The enclosed evidence demonstrates that:

- An international network and in some cases the specific ability to service the Tasman is critical to corporate/government and high frequency travellers as reflected in various tenders **[CONFIDENTIAL]**.
- The benefit of the Alliance has allowed Virgin Australia to provide a new strong, comprehensive and competitive offer as reflected in its successful tenders to **[CONFIDENTIAL]**.
- The Game Change Program and the Alliance has resulted in an improved fare and service offering for consumers with competitive tension triggering a competitive response from Qantas as evidenced by the increase in corporate discounts and promotional activity.
- Qantas specifically markets its frequency advantage to gain corporate accounts **[CONFIDENTIAL]**.
- The dominance of Qantas is reflected in the stickiness of customers and the difficulty of winning corporate/government business and high frequency travellers from Qantas. **[CONFIDENTIAL]**.
- Compared with the Qantas Alliance offering (including both routes flown, frequency of flights and frequent flyer benefits), a standalone Virgin Australia offering without the Alliance would not be competitive. This is discussed further in **Section 1.3**.

Conclusion:

- Reauthorisation of the Alliance is pro-competitive and is critical to enhancing competition and creating a genuine choice of airlines for all Australians.
- The Alliance has resulted in product and service improvements.
- The benefits of the Alliance enable Virgin Australia to provide a competitive constraint to the Qantas Alliance on the Tasman and allows greater competition for corporate/government and

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high frequency travellers in domestic Australia.

- This has resulted in an improved fare and service offering for consumers with competitive tension triggering a competitive response from Qantas as evidenced by the increase in corporate discounts and promotional activity.

1 The Alliance is critical to Virgin Australia's Game Change Program and enabling competition on the Tasman and in domestic Australia

1.1 Supplementary evidence regarding the dominance of the Qantas Alliance in the provision of services to corporate and government travellers and international travel to and from Australia

Virgin Australia's Game Change Program aims to bring much needed competition to the dominant position of the Qantas Group in the provision of services to corporate and government travellers and international travel to and from Australia.

Virgin Australia has submitted that the Alliance is critical to enabling Virgin Australia to have an offer that can effectively constrain the Qantas Alliance in the provision of services to corporate/government travellers and high frequency travellers in the region.

Enclosed is the following recent supplementary evidence in support of the above:

[CONFIDENTIAL].

For further information, the Commission may also wish to contact:

[CONFIDENTIAL].

As noted by the Commission in its Final Determination for the Qantas/Emirates authorisation, Qantas provides in excess of 50% of Australian domestic air passenger services each year.¹ This has enabled Qantas to build significant customer loyalty reinforced by Qantas' frequent flyer program and the contracts Qantas has with government and business organisations for domestic and international travel creating customer stickiness in favour of Qantas services.

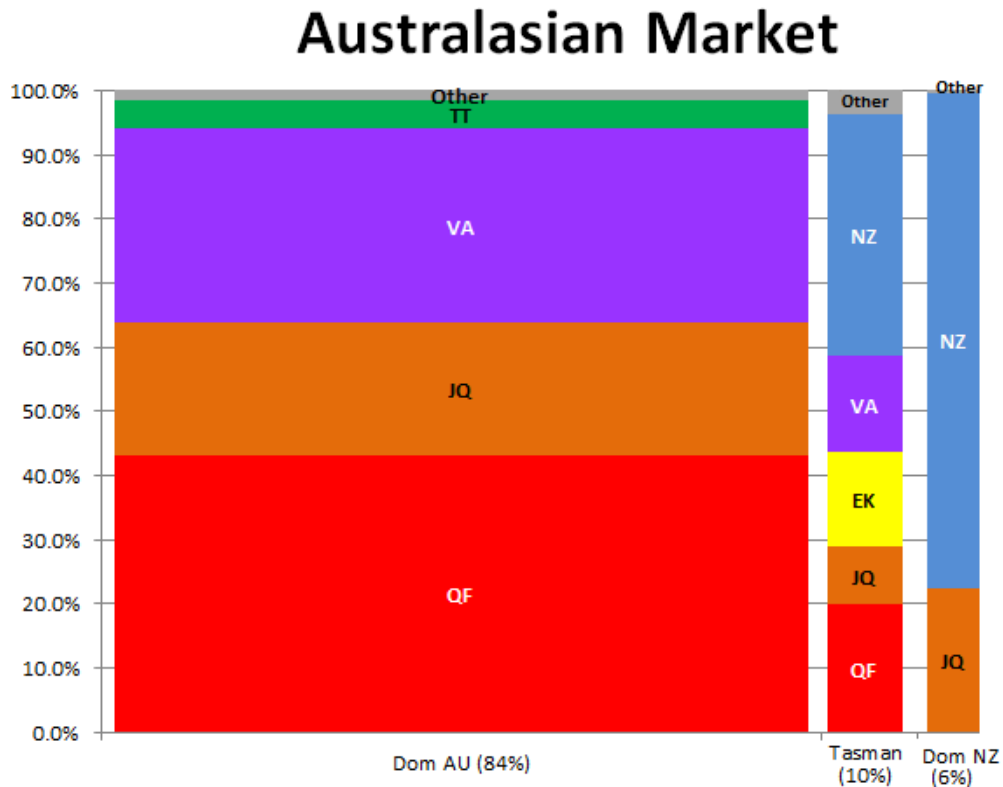
Qantas historically had a broad international network covering North America, Asia and Europe. This has been further expanded by their alliance with Emirates and they now have even greater ability to bundle international and domestic air passenger transportation services to corporate customers in such a way as to foreclose airline competitors in the domestic market. This can be seen in Figures 1 and 2 below. Qantas' main competitor for corporate customers that wish to acquire both domestic and international air passenger transport services from a single provider is Virgin Australia through its virtual international network created by alliances such as the Alliance with Air New Zealand.

Evidence of the stickiness and the difficulty in winning business away from Qantas, as well as Virgin Australia being Qantas' main competitor for corporate customers is reflected in:

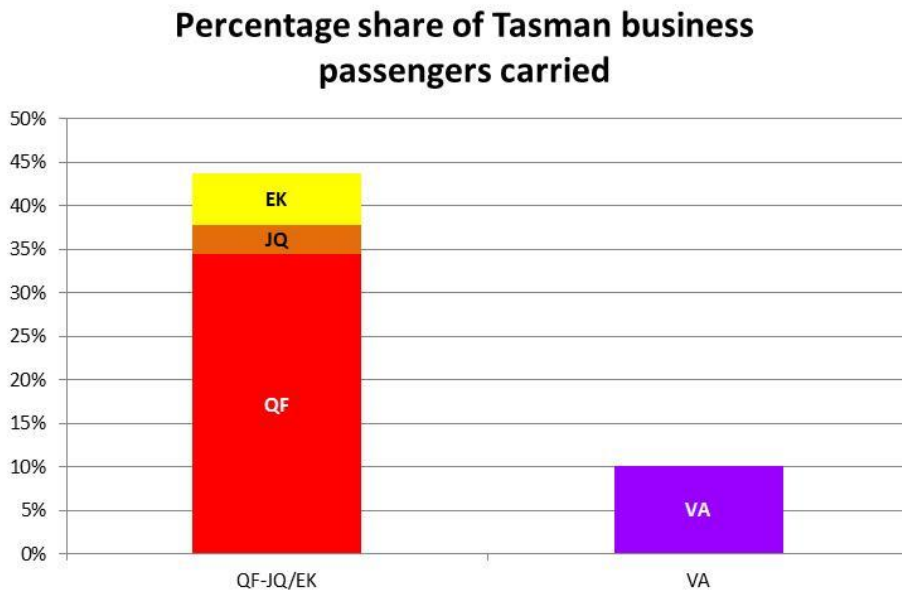
[CONFIDENTIAL].

¹ See ACCC, Qantas Airways Limited & Emirates - Authorisations - A91332 & A91333, Final Determination at paragraph 182.

Figures 1 and 2. Australasian Market and Tasman business passengers carried



*Source: Based on ASKs from Diio Mi (YE June 2013), <https://www.diio.net/products/diio-mi/>.



*Source: DIAC data.

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No matter how good Virgin Australia’s domestic product is, it will always face limitations in attracting corporate accounts and high frequency travellers away from the Qantas Group (now part of the Qantas Alliance) if it cannot offer a competitive international network with destinations, frequencies and enhanced product offering (including loyalty program and lounges) all of which attract such passengers. This is true whether or not air services are being purchased from a single provider as is reflected in the following recent evidence:

[CONFIDENTIAL].

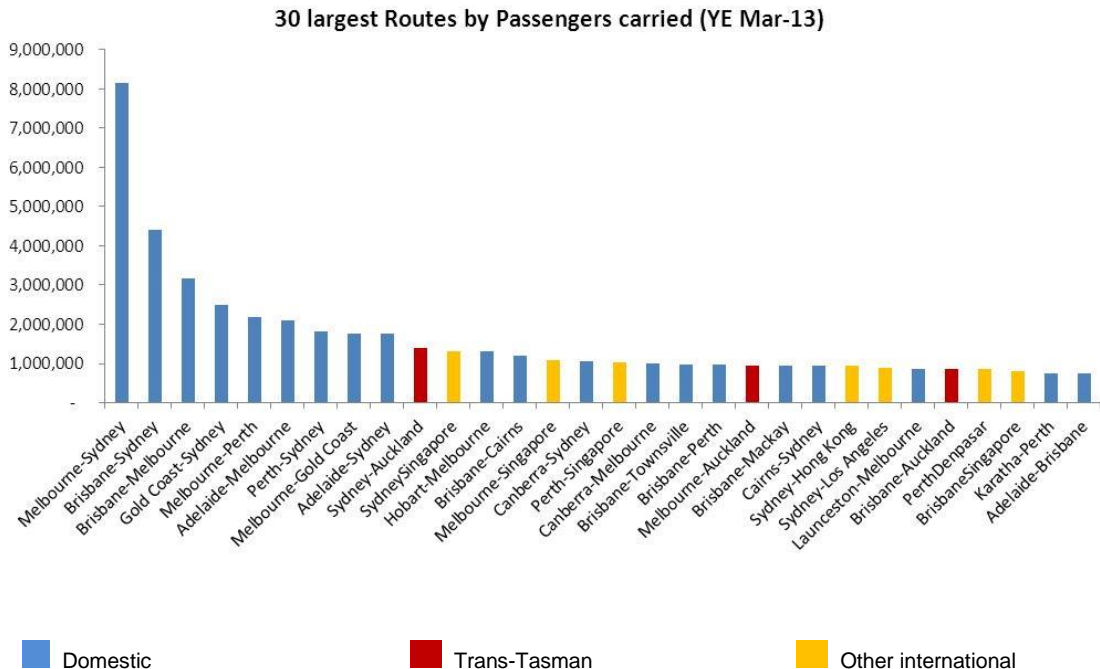
1.2 Supplementary evidence on the importance of the Tasman to the Game Change Program and competition for Australian corporate/government and high frequency travellers

New Zealand is Australia’s largest inbound market by arrivals and Australia’s most popular overseas travel destination. There is a large degree of integration between the Australian and New Zealand economies and business communities. A large number of companies have operations in both countries and there is a high degree of dual destination travel. As a result, the ability to service trans-Tasman routes and provide domestic Australian and New Zealand connections can be a non-negotiable feature for Australian corporate/government clients when tendering for air service providers. Virgin Australia has provided some example corporate tenders which evidence the requirement for Tasman services in corporate tenders. In particular, please see the documents provided in relation to the tenders for [CONFIDENTIAL]:

[CONFIDENTIAL].

As shown in **Figure 3** below, the Auckland-Sydney, Auckland-Melbourne and Auckland Brisbane routes are in the top 10 largest routes by passengers for flights from Australia (first, fifth and eighth largest respectively).

Figure 3. 30 largest routes by passengers carried (for year ending March 2013)



*Source: BITRE data.

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Even if the corporate/government or high frequency traveller is not spending a large volume on trans-Tasman services or does not fly on the Tasman at all, the ability to provide trans-Tasman services is still often important to being able to win business against or away from Qantas/Emirates which can offer such services. For example, an Australian corporate traveller will place value on the option to burn frequent flyer points earned from business trips on a holiday to New Zealand. Tasman travel may not be a regular part of the business travel but the option to have it included in a travel package at a better rate is of value to customers and something Qantas/Emirates can provide. In Virgin Australia's experience clients do not assess a particular offer in isolation but significantly evaluate the gap in the offer relative to other offers. For further evidence on this point, please see the documents provided in relation to the [CONFIDENTIAL].

Without a competitive offering on the Tasman, a critical part of the regional jigsaw is missing and there is no genuine choice for corporate/government customers particularly when these air passengers' services are being bought from a single provider bundling domestic and international services.

1.3 Supplementary evidence on the importance of the Alliance to the Game Change Program and competition for Australian corporate/government and high frequency travellers

Virgin Australia has submitted that without the Alliance, Virgin Australia would not be able to offer customers the key features they value in a way that would competitively constrain the Qantas Alliance.

Based on Virgin Australia's corporate sales experience including tender discussions, successful tenders and customer feedback on lost tenders such as [CONFIDENTIAL], it is clear to Virgin Australia that the key drivers of airline choice for Australian corporate/government and high frequency travellers include:

- network reach and connections;
- frequency and flight times;
- access to lounges;
- the existence of a competitive loyalty program for status and FFP and the ability to earn and burn across a broad network; and
- price and service.

Furthermore, the requirement by corporates in various agreements (for example, [CONFIDENTIAL]) demonstrates that a frequent flyer proposition is an important driver of choice for corporates.

Table 2 below summarises the offers that Virgin Australia is able to provide currently with the Alliance, absent the Alliance and the offer provided by the Qantas Alliance in terms of the key drivers behind corporate purchasing. This demonstrates that absent the Alliance, Virgin Australia's offering would no longer be competitive with the Qantas Alliance.

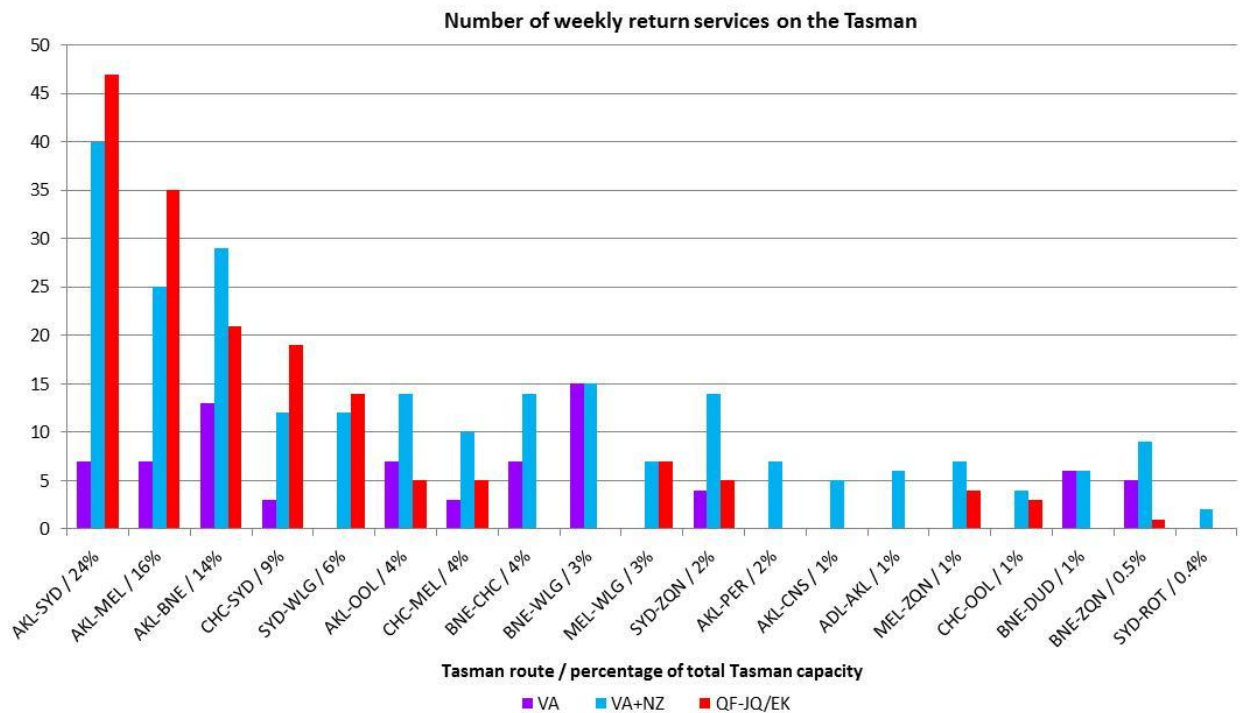
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Table 2. Drivers of corporate purchasing

Driver of corporate purchasing	VA with the Alliance	VA absent the Alliance	Qantas/Jetstar/Emirates
High frequencies	✓	✗	✓
Convenient schedule times	✓	✗	✓
Extensive connections in Australia and New Zealand	✓	✗	✓
International lounges in Australia and New Zealand	✓	✗	✓
Comprehensive Loyalty Earn and Burn	✓	✗	✓
Strength across all distribution channels in Australia and New Zealand	✓	✗	✓
On time performance	✓	✓	✓
Value for money	✓	✓	✓

Furthermore, Virgin Australia would not be competitive with the Qantas Alliance in terms of its frequency offering on the Tasman. This is reflected in **Figure 4** below which shows Virgin Australia standalone, the Alliance and the Qantas Alliance frequency comparisons on Tasman routes.

Figure 4. Frequency table



*Source: Data obtained from Diio Mi for a week in July 2013 <https://www.diio.net/products/diio-mi/>.

Table 3 below provides a comparison of Virgin Australia with and without the Alliance and the Qantas Alliance against the key features or proxy metrics that travellers have shown they value.

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Table 3. Comparison table of Virgin Australia with and without the Alliance and Qantas/Jetstar/Emirates

	VA Without the Alliance (based on current operating schedule)	VA With the Alliance	Qantas Alliance
Frequencies and schedule	Schedule returns to a limited, low frequency schedule driven by aircraft utilisation.	Optimised schedule with better spread and more departures. Access to Air New Zealand's high frequency on trunk routes.	High frequency, premium product offering. On the major business routes Qantas/Emirates has a major frequency advantage over Virgin Australia with a 53% frequency share on Auckland-Sydney compared with Virgin Australia's 6% and a 57% frequency share on Auckland-Melbourne compared with Virgin Australia's 12%.
<i>Daily services from Auckland to:</i>			
<i>Brisbane</i>	2	4	3
<i>Melbourne</i>	1	5	6
<i>Sydney</i>	1	6	6
Network reach in New Zealand and Australia	34 Australian points 5 New Zealand points 170 combinations	34 Australian points 27 New Zealand points 918 combinations	60 Australian points 5 New Zealand points 300 combinations
Capacity share (Actual, YE Mar-13)	16%	51%	47%
International air-side lounge access	0	At all international departure ports in Australia and New Zealand	At all international departure ports in Australia and New Zealand
New Zealand domestic lounge access	0	12	0
Loyalty program	Strong domestic Australia proposition but trans-Tasman earn and burn proposition limited to Virgin Australia's schedule, with	A compelling FFP proposition for trans-Tasman travellers. Ability to earn and burn across trans-Tasman, domestic Australia and domestic New Zealand.	Strong domestic Australia proposition complimented by high frequency proposition on the Tasman. Strength in both New Zealand and Australian market.

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	VA Without the Alliance (based on current operating schedule)	VA With the Alliance	Qantas Alliance
	<p>limited frequency.</p> <p>No earn and burn in domestic New Zealand.</p> <p>Limited penetration in New Zealand market.</p>	<p>Strength in New Zealand through Air New Zealand Airpoints membership base.</p> <p>Virgin Australia passengers gained FFP access on an additional 190,000 New Zealand services in Year 1.</p>	<p>Ability to earn and burn across Qantas Alliance global network. There are approximately 8.6 million Qantas frequent flyer members and one million Australian members of Emirates' frequent flyer program, Skywards.²</p>
Customer facing product	<p>Product improvements are ongoing, but all services operated on narrow body aircraft.</p> <p>No business class.</p>	<p>Optimised schedule with narrow and wide body aircraft providing more choice and a long-haul style wide body product (including full business class).</p>	<p>Optimised schedule with narrow and wide body aircraft providing more choice and a long-haul style wide body product (including full business class).</p> <p>Business class sold on all Qantas and Emirates flights, including narrow body aircraft.</p>
Distribution network	<p>Strong point of sale presence in Australia but not in New Zealand.</p> <p>[CONFIDENTIAL].</p>	<p>Strong point of sale presence in Australia and Air New Zealand's point of sale strength in New Zealand. Air New Zealand's strength in indirect channels.</p> <p>[CONFIDENTIAL]% of total Alliance passengers for 2011 and 2012 were sold by Air New Zealand.</p>	<p>Strong point of sale on both sides of the Tasman</p> <p>Well established commercial infrastructure in New Zealand (incorporated in New Zealand since 1956)</p>

In addition to the information provided above, enclosed is:

[CONFIDENTIAL].

1.4 Supplementary evidence showing that the Game Change Program is achieving results

Consumers have shown they value the benefits provided under the Alliance with increased passenger numbers on Alliance services (increase of [CONFIDENTIAL]% from the Pre Alliance Year to Year 1 on combined Virgin Australia and Air New Zealand operated flights) including from both stimulated demand and switching from Qantas. There has also been a substantial increase in the Velocity frequent flyer membership from [CONFIDENTIAL] at the end of FY2010, to [CONFIDENTIAL] at the end of FY2012.

The Alliance has enabled Virgin Australia to win significantly more corporate accounts - for example, accounts with [CONFIDENTIAL]. As noted in Virgin Australia's response to question 8 of the ACCC's

² See ACCC, Qantas Airways Limited & Emirates - Authorisations - A91332 & A91333, Final Determination at paragraph 246.

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13 May 2013 information request it is estimated that the percentage of total earned revenue from the corporate sales channel for domestic Australia has increased - this trend has also been observed on the Tasman, combined with the benefit of Air New Zealand sales onto Virgin Australia, and the ability to leverage Air New Zealand's strength in the corporate market in New Zealand.

The competitive constraint brought by the Game Change Program and the Alliance has resulted in an improved fare and service offering for consumers with competitive tension triggering a competitive response from Qantas. This is evidenced by the reduction in the lead-in price differential on various domestic routes between Qantas and Virgin Australia due to Qantas' need to reduce their prices to respond to competition from the Alliance. Similarly, Virgin Australia notes that Qantas has [CONFIDENTIAL] in response to Virgin Australia competing in this area.

2 Without the Alliance, current trans-Tasman capacity and services will not be sustained

2.1 Overview

Virgin Australia has previously submitted that:

- In terms of actual Profit Before Tax (PBT) for June 2012 to May 2013, [CONFIDENTIAL].
- [CONFIDENTIAL].
- Absent the Alliance, [CONFIDENTIAL] Virgin Australia's domestic Australian business will suffer due to the loss in connectivity in trans-Tasman routes operated via Air New Zealand.
- If the Alliance is not reauthorised, Virgin Australia will review the viability of operating each of its trans-Tasman services and will withdraw capacity and services on routes in accordance with their commercial business performance. As part of this review, Virgin Australia will consider each route absent Alliance benefits and weigh this up against any network benefit obtained from continued standalone operation of that route.
- The likely outcome of such a review would be to either exit or withdraw capacity from poor performing routes resulting in a less competitive environment across the Tasman and less genuine choice for consumers.
- [CONFIDENTIAL].

Virgin Australia made its submissions on the likely outcome of a review of the viability of Tasman services based on an internal route by route analysis prepared to assist the Commission in its enquiries. This analysis showed that [CONFIDENTIAL]. As requested by the Commission this analysis has been provided below.

2.2 Analysis of route profitability with and without the Alliance

Table 4 below provides an analysis of route profitability with and without the Alliance

[CONFIDENTIAL].

Table 4. Analysis of route profitability with and without the Alliance

[CONFIDENTIAL].

Without the Alliance there would be a loss to Virgin Australia of direct benefits associated with the Alliance such as:

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- direct benefits including Air New Zealand's sales strengths (eg, point of sales operations);
- New Zealand domestic feed onto Virgin Australia operated flights;
- redemption bookings from frequent flyer program (**FFP**) reciprocity; and
- any corporate traffic trans-Tasman routes secured due to Air new Zealand's complimentary trans-Tasman network.

Virgin Australia estimates that the total value of these lost benefits will conservatively be valued at [CONFIDENTIAL].

Indirect Alliance benefits include:

- revenue from Virgin Australia flights sold under the Alliance in connection with Virgin Australia or Air New Zealand's operated trans-Tasman flights [CONFIDENTIAL];
- corporate revenue on other Virgin Australia flights (eg, domestic flights in Australia) secured due to the benefits available on trans-Tasman sectors under the Alliance [CONFIDENTIAL]; and
- loyalty-driven revenue on other Virgin Australia flights (eg, domestic flights in Australia) that have been secured due to loyalty generated by the trans-Tasman network available under the Alliance [CONFIDENTIAL].

Virgin Australia estimates, conservatively, that these indirect benefits are currently valued at [CONFIDENTIAL].

The data in **Table 4** evidences that:

[CONFIDENTIAL].

Difficulties faced on Tasman routes without the Alliance

Absent the Alliance, there would be a number of challenges to maintaining current operations on Tasman routes. [CONFIDENTIAL].

Without the Alliance, assuming no capacity change, Virgin Australia would lose many of the indirect benefits of current trans-Tasman operations. Virgin Australia would also lose all revenue advantages that the Alliance gives on direct route profitability including point of sale presence in New Zealand, feed from domestic New Zealand services and an optimised schedule. [CONFIDENTIAL].

[CONFIDENTIAL].

Presence on a route alone is not enough for Virgin Australia to attract substantial corporate or frequent travellers. As discussed above, the ability to capture these passengers is influenced by the air service provider's ability to address a number of key factors including:

Schedule frequency/depth:

- Absent the Alliance, Virgin Australia would return to operating a comparatively limited schedule which would have limited appeal to corporate customers.
- The Qantas Alliance has a major frequency advantage over Virgin Australia on most Tasman routes. The lack of frequency share and availability of departure / arrival times in both directions that corporates and high frequency customers desire will severely limit Virgin Australia's ability to attract corporate customers on a standalone basis.

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- Purchasing the required number of aircraft to match the frequency offering of the Qantas Alliance would not generate sufficient return on capital or be approved by shareholders. Substantial capital expenditure would be required to provide sufficient breadth and depth of schedule without the ability to recoup those costs within a reasonable time. This strategy would involve time lags in terms of deploying the aircraft and building the traffic for such services without the benefit of feeder traffic from Air New Zealand and it would result in increased operational costs.

Strong product offering:

- Virgin Australia has also benefited from the ability to sell seats on Air New Zealand's widebody aircraft which are regarded as a stronger product than the narrowbody B737-800.
- The Air New Zealand widebody aircraft are also equipped with Business Class which is a key offering for corporate customers. In addition, it is more challenging to compete with a smaller capacity aircraft from an inventory perspective.

Point of sale strength:

- The strength of the Alliance rests on the fact that Air New Zealand and Virgin Australia are largely complementary businesses. Virgin Australia has strong point of sale in Australia, but not in New Zealand.
- This is unlike the Qantas Alliance whereby Qantas and Emirates each have a strong point of sale presence on both sides of the Tasman. Qantas has well established commercial infrastructure in New Zealand, having been incorporated in New Zealand since 1956. Emirates is equally strong in both Australia and New Zealand, having operated in both as key online markets for trans-Tasman and long haul traffic.

Strong international lounge proposition:

- Under the Alliance, each airline allows their paid lounge membership program members virtually unlimited use of each other's lounges when travelling on the Tasman or on each other's domestic network. This benefit would not continue absent the Alliance.
- This arrangement allows Virgin Australia's lounge members in Australia to use Air New Zealand's international lounges in Australia and New Zealand when travelling on the Tasman. This level of access would otherwise not be possible for these customers unless:
 - they achieved the relevant tier status on an applicable frequent flyer program; or
 - they paid to join Air New Zealand's paid lounge membership program in addition to Virgin Australia's lounge program.

Strong Frequent Flyer offering:

- From a frequent flyer program perspective, it is also assumed that both parties would review accrual and redemption access and commercial terms absent the Alliance. [CONFIDENTIAL] Velocity Rewards' airline accrual partners are currently limited to Virgin Australia's codeshare partners. Absent the Alliance it is therefore likely that [CONFIDENTIAL] Velocity Rewards members in Australia and New Zealand (as at the end of FY12) would no longer be able to accrue points on Air New Zealand services, or redeem points across Air New Zealand's network. This is seen as a major deterrent in attracting corporate customers.
- There are other benefits reciprocally available to Virgin Australia's high value guests travelling on Virgin Australia's services that would be in jeopardy absent the Alliance. These include priority check in, priority baggage handling, additional checked baggage allowances, additional

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cabin baggage, priority seating and priority boarding. These benefits have been identified as key drivers of customer choice amongst tiered frequent flyer program members who are entitled to receive them. Absent the Alliance, the frequency of services on which these benefits are available to these guests would immediately be limited unless they were able to attain the required status level on both airlines' frequent flyer programs or switch to the Qantas Alliance loyalty program.

[CONFIDENTIAL].

2.3 Competitive environment

[CONFIDENTIAL].

Table 5. Evidence of less competitive environment without Alliance

Airline	Actual (YE Mar-13)		[CONFIDENTIAL]
	Passenger share	Capacity share	
Air New Zealand	37%	35%	
China Airlines	2%	2%	
Emirates	14%	15%	
Jetstar	10%	9%	
Qantas Airways	22%	22%	
QF-JQ-EK group	46%	47%	
Virgin Australia	16%	16%	
Total Tasman	100%	100%	

*Source: BITRE data.

[CONFIDENTIAL].

This would be a significantly less competitive outcome, given the dominance of the Qantas Alliance.

Confidential Annexure A – Index of supporting evidence

[CONFIDENTIAL]