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UK regional airport commercialisation and privatisation: 25 years on

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ABSTRACT

It has been 25 years since the UK was the first country to begin the process of commercialising and privatising its airports. The purpose of this paper is to revisit the UK Government's stated aims with respect to commercialisation and privatisation, namely to "encourage enterprise and efficiency in the operation of major airports ... [and that] ... air transport facilities should not in general be subsidised by the taxpayer ... [and they] should normally operate as commercial undertakings." The authors of this paper consider the success of commercialisation and privatisation against these aims with respect to the 16 UK regional airports commercialised by the 1986 Airports Act part II. In addition, this paper considers the policy ramifications that have eventuated. The authors argue that many of the benefits may have been achievable by commercialisation alone.

1. Introduction

The UK was the first country to embark on a path of full airport privatisation with the introduction of the 1986 Airports Act. Prior to this, UK airports had depended on subsidies from the UK tax payer to local and central government. Up until the mid 1980s airports were regarded as public utilities to be owned and subsidised by Government. Since then there has been a significant shift in many countries towards airports becoming financially self sufficient entities, run on a commercial basis and funded fully or partly by the private sector. To date over 80 countries have introduced some form of private ownership to their airports and a number of other countries are considering the possibilities.

This paper makes a distinct contribution to the literature on airport commercialisation and privatisation. Firstly it seeks to measure the outcomes of UK commercialisation and privatisation against the stated policy objectives set by the Government (Graham, in press). Secondly, although work on UK airport privatisation has been undertaken, (Humphreys, 1999; Francis and Humphreys, 2001; Humphreys et al., 2007; Graham, 2008) an updated review of progress in the UK is valuable given the dynamic changes in ownership that have taken place and are continuing to take place. Thirdly, the UK offers the longest case of the implications of airport commercialisation and privatisation since it was one of the first countries to do so. The associated findings therefore offer an unparalleled example of the issues for management, policy makers and planners related to commercialisation and privatisation. Finally, in taking the UK case for regional airports this paper considers the impact of the policy of commercialisation for airports of varying sizes and ownership structures within the same National context, not covered by previous studies that have mainly focussed on specific airport case studies or the airports owned by the BAA (Parker, 1999; Francis and Humphreys, 2001).

For the UK case the policy objectives for airports in relation to a transformation of the basis upon which airports were operated were set in the 1985 UK Government White Paper as follows:

- To encourage enterprise and efficiency in the operation of major airports by providing for the introduction of private capital.
- Air transport facilities should not in general be subsidised by the taxpayer or the rate payer. Airports, whoever their owners should normally operate as commercial undertakings.
  Source: Department of Transport Airports Policy White Paper, 1985, Cm 9542, p. 5.

This paper has three aims. Firstly, to consider the extent to which the above Government policy objectives for airports have been realised, secondly, to review the changing pattern of UK regional airport ownership structures with reference to the 1986 Airports Act part II and thirdly, to examine the implications for airport policy and planning.

2. UK airport ownership policy

The UK Government transferred the ownership of the British Airports Authority from the Government to the private sector on the first of April 1987. This meant that seven airports responsible for over 65% of UK airport passenger traffic and including

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Heathrow, the busiest international airport in the world and London Gatwick airport (second busiest in the UK), Stansted, Southampton, Edinburgh, Glasgow and Prestwick were privatised and together these airports became subsidiaries of the BAA plc which became listed on the UK stock market.

The focus of this paper is on the remaining 16 airports that had a turnover of more than £1 million per annum in two of the previous 3 years which were commercialised. These 16 airports were responsible for around 30% of UK air passenger traffic. The Act commercialised these airports such that they had to make a profit and could no longer receive subsidies. The 1986 Airports Act enabled Local Authorities to sell all or part of their shares in their airports if they so wished. As limits were placed on Public Sector borrowing, airports that required investment increasingly sought private ownership in part or fully. For example, in 1991 the UK Government facilitated borrowing for Local Authority Airport Companies in response to major terminal development at Manchester and introduced a system whereby Airport Companies could borrow from private sector sources.

Prior to the Airports Act, publicly elected councillors took management decisions, airport charges were set centrally and staff wages were determined centrally by the National Council for airports. The Airports Act freed airports and gave management the authority to take commercial decisions. However, regulation of airport charges and accounts was introduced by the Government and administered by the Civil Aviation Authority (CAA) in order to protect the airlines from monopolistic practices by airport operators. Of all the airports in the UK only Heathrow, Gatwick, Stansted and Manchester airports received price cap regulation on their aeronautical charges imposed by the CAA. These four airports were regarded as requiring their charges to be regulated because of their strong market position. The airport charges were and still are regulated under the 'single till' principle where all income (aeronautical and commercial) is considered prior to setting the aeronautical charges, and thus income earned from commercial sources in a sense subsidises the airport charges. Manchester has since been freed from regulation of its charges on the grounds that the growth in competition for airline services from other airports has meant that it no longer has a dominant market position.

The 1986 Airports Act required airports to produce transparent accounts for the CAA and each airport had to apply to the CAA to levy aeronautical charges. Safety continued to be regulated by the CAA across all airports. Further policy developments have taken place that aim to shape the future of UK airports, most notably the 2003 White Paper on the Future of Air Transport (2003) that sought to identify desirable locations for airport capacity expansion to accommodate future forecast air transport growth. Although in 2010 the new UK coalition Government stated that there will be no additional runways at Heathrow or Stansted as proposed in 2003.

3. Method

This paper forms part of a longitudinal study from which a series of papers written by the authors (Humphreys, 1999; Francis and Humphreys, 2001; Humphreys and Francis, 2002; Humphreys et al., 2007) have traced the developing trends and emerging policy issues in the years following UK airport commercialisation and privatisation. The performance of airports is considered in relation to the stated aims in the Airports Act (1986). Sources utilised include the Airports Act (1986), airport annual reports, published statistics, namely the statistical series for the UK Airports Industry, 2001–2009 from which the commercial revenue and the revenue expenditure tables have been calculated, government legislation and selected government reports.

In order to assess airports performance in relation to the objectives set by the government we have chosen to use two key ratios. Namely the revenue expenditure ratio (Revex ratio) and the ratio of commercial revenue as a percentage of total revenue. These two ratios were chosen as they are particularly relevant to the airport sector. The longitudinal data was also available to the authors. The percentage of commercial revenue and Revex ratios has been calculated for each of the 16 commercialised regional airports in the UK over the period 1986–2009.

The authors believe this approach to be complementary to other approaches such as DEA. In appraising airport commercial performance ratios are frequently used although "at present, there is no accepted industry practice for measuring and comparing airport performance in a consistent and systematic manner" (Oum et al., 2003). Different methodologies have been applied by different authors, for example using Data Envelopment Analysis (Martin and Román, 2001; Chin and Siong, 2001; Parker, 1999), and Malmquist total factor productivity (Hooper and Hensher, 1997; Abbott and Wu, 2002; Nyshadham and Rao, 2000). It could be that increased efficiency is shown simply by increased profits or increased passenger numbers, but simply comparing the profits of airports is meaningless if they handle different traffic volumes (Assaf, 2009, 2010).

3.1. The Revex ratio

There are difficulties in measuring the efficiency gains that are obtained as a result of privatisation, not least since it is not possible, with any certainty, to assess how they would have performed if they had not been privatised. There is also the added complication of separating out the efficiency gains from privatisation as opposed to commercialisation. Notwithstanding one approach which has been used is that of using what is known as Revex (revenue to expenditure ratio). This ratio looks at the ratio of operating revenue to operating expenditure. It gives an indication of the relative operating profit of the airport and thus how well costs have been controlled/covered by operating income. The ratio has its limitations since it is a relative rather than an absolute measure of performance. The Revex ratio is described by Doganis (2001) and Graham (2008).

The Revex ratio is calculated as follows:

$$\text{Revex ratio} = \frac{\text{operating income}}{\text{operating expenditure}}$$

The Revex ratio is the total revenue of the airport expressed as a ratio of the total costs after depreciation and interest and before tax. The Revex ratios in this case do not include depreciation or interest and therefore look at the airports operating costs in relation to revenues generated. This eliminates the potential distortions from financing decisions (interest) and accounting treatment (depreciation) to facilitate comparisons. The use of operating costs is consistent with measures such as NOPAT and EBITDA. The higher the value of the Revex ratio, the higher the airport's profitability. For example, a ratio of 1.01 indicates revenue exceeds costs by 1% (Doganis, 2000). The numerator and the denominator inform with respect to airport performance, for example the operating expenditure aspect will reveal how well costs are utilised in relation to revenues generated and is indicative of efficiency. Operating income is important to commercialised/privatised airports. This is further broken down into the ratio of commercial revenue as a percentage of total revenue.