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Analysing air operators’ managerial perceptions of incentives for competing for regional PSO air services within Europe

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ABSTRACT: While it has been established in previous research that public support for air services to peripheral or economically underdeveloped regions is justifiable, the current EU Public Service Obligation (PSO) air service mechanism and particularly the level of competition for PSO contracts can be improved. This paper set out to identify best practice from different European policy approaches by viewing issues from an air operator perspective. The heart of this paper is a survey of European regional air service providers. We examine the airline managers’ perspectives in relation to assessing and bidding for PSOs on scheduled air services. Proposed improvement areas include issues around the simple dissemination of PSO opportunities in the single market, adequate response times for proposal preparation/submission and in preparing for a start date, incentives to develop the air service during the contract period in terms of revenue and patronage. We also identify entry barriers as well as issues around risk sharing, transparency and effectiveness of PSO contract awarding procedures and trust issues with procurement authorities.

KEY WORDS: Regional aviation, PSO air services, incentives, contracts, trust, route development, competition

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DATE: November 2014
1. Introduction and setting the scene

Whilst airlines around the globe find it difficult to generate sustainable profit margins (e.g. Merkert and Pearson, 2014), it is unsurprising that this is particularly pertinent in peripheral areas, where air services are often essential to the social and economic life of the region, whilst patronage levels are on average low. Scheduled air services are therefore often regarded as public goods in regions where such services are not commercially viable. This in turn results in government intervention in the form of providing, protection from route competition, guaranteeing part or most of the revenues, subsidising these services and/or guaranteeing minimum service levels such as timetabling and maximum fares (for an overview of possible interventions including their social welfare implications see Nolan et al., 2005). If governments, public transport or regional authorities procure such transport services (as opposed to producing them internally), they are governed by a contractual relationship between a principal (transport authority) and agent (operator) (for details on the agency theory see Eisenhardt, 1989). Examples for public support for air services exist in many countries; the most noteworthy being the Essential Air Service (EAS) program in the United States (e.g. Wittman, 2014; Matisziw et al., 2012), the PSO air service scheme in Europe (e.g. Merkert and Williams 2013), the Remote Air Services Subsidy (RASS) Scheme in Australia (e.g. Merkert and Hensher, 2013) as well as similar schemes in India and Canada (e.g. Metrass-Mendes et al., 2011; Ouellette et al., 2010). Albeit despite on-going austerity pressures the remote air service policy debates are active in all of the regions mentioned above as there is increasing interest in making the PSO air services more efficient to improve their value for money. We argue that austerity (or any cost reducing) pressure also offers a chance for government officials to take a fresh look at the way they procure such services. Such reviews should not be dominated by existing practice, which will usually favour the incumbent operator. Effort can be made to seek innovative ideas to make their contract offers more attractive to operators and more financially viable for the public purse.

In Europe the approved approach is to procure public service obligation (PSO) air services (e.g., Reynolds-Feighan, 1995) and it has been shown that air PSOs in Europe contribute significant social and economic benefits (Bråthen and Halpern, 2012). However, despite the European Commission’s harmonisation aspirations, the interpretation and application of the PSO air service mechanism differs substantially across the European member states (e.g. Merkert and Williams, 2013). A member state may impose PSOs on dedicated routes or a bundle of routes, if it judges that air services are vital for the economic and/or social development of the regions these routes serve and that without subsidies (either to the airlines or to local residents as is the case in Spain, e.g. Cabrera et al., 2011) and/or regulatory measures to protect them, no satisfactory scheduled air services to these regions would be maintained. In many ways this illustrates that the politics of regulatory governance matter. As the
interpretation of the relevant European Commission directives can be challenged in court, their potential latitude of interpretation does not only highlight the need for local adaption, but also permits local transport authorities and operators to come forward with innovations and different approaches that have the potential to improve the cost-efficiency and value of their specific PSO services in any particular country.

As identified in Merkert and O’Fee (2013), there are many areas where European PSO air service operations can be improved with one being to increase the level of competition for such air services. It has been shown that this is the unanimous view of the European public transport authorities, as they are well aware of the price, efficiency and consumer advantages resulting from competition in other sectors. However, an enduring feature of the European PSO tendering process is how few operators actually compete on routes. Figure 1 illustrates exemplarily the level of competition for PSO air routes in Norway in 2013.

Despite best efforts the Norwegian Ministry of Transport and Communications nearly 50% of the PSO bundles tendered in 2013 were uncontested and the majority of the remainder only had two contestants. Only 10% of the routes offered had more than two contestants with both of the relevant routes targeting the capital airport. As most of the routes in Norway have not much competition from other modes of transport (Merkert and Mangia, 2014), the government is keen on encouraging competition for the PSO tenders. Our previous work has suggested that the motivation of transport authorities in other European countries in terms of achieving reasonable levels of competition for PSO services is often less and hence it is probable that even less competition for PSOs is experienced in
those regions. A particular issue appears to be cross-border competition for such contracts (Merkert
and O’Fee, 2013).

This paper aims to understand some of the reasons behind the apparent lack of competition for
European public air services by evaluating senior management views of both airlines who currently
operate PSO air service contracts in Europe and those who have operated PSO contracts in the past or
are potentially in a position to enter the PSO air service market in the future. This has never been
attempted before. From our previous studies we know that PSO airline efficiency (Merkert and
Williams, 2013) and PSO contracts can be improved (Merkert and Hensher, 2013), and we know
something of the view of one side of the contractual relationship, namely the public transport
authorities (Merkert and O’Fee, 2013). What we do not know is the view of airline managers on what
inspires, or does not inspire, them into competing for, and operating, PSO contracts in their home and
other European markets (including issues surrounding business development, trust, contracts etc.).
The air operators’ views will help produce a mirror image to the PSO authorities’ views presented in
our previous work.

The remainder of the paper is structured as follows: Section 2 introduces the methodology. Following
a discussion of our key findings in section 3 and we present our conclusions and some policy
recommendations in section 4.

2. Methodology and sample
Based on the literature review of the preceding section, we aim to shed light on airline managers’
perspectives on PSO practices of their home and other European markets, which includes incentives,
contractual arrangements and the relationship (i.e. trust) in the procuring/tendering public transport
authorities. As the competition for PSO air contracts is not very intense in terms of number of
contestants, we wanted to test various attitudes regarding perceptions of unattractive risk sharing and
trust between the operators and authorities (i.e. outside the operators’ home markets) as well as
possible perceptions about lack of transparency. In order to establish evidence on this, we carried out
a survey of PSO and non-PSO EU air operators, who are all eligible to bid for PSOs.

As a first step we endeavoured to compile a comprehensive list of European regional passenger
service air operators. We even included some air cargo and ACMI operators who could conceivably
migrate to passenger services with the right opportunity. We then endeavoured to find a named senior
contact within that airline to answer our survey appropriately. One early impression from these
efforts, was to underline the significant amount of consolidation that has taken place in the European
regional airline since the last market structure analysis by one of the authors in 2012 (Merkert and
Williams 2013). While many commentators and the public are aware of the big mergers, such as the one between British Airways and Iberia that formed International Airlines Group, financial failures (e.g., Sky Europe, Highland Airways, Augsburg Airways, OLT, Cirrus Airlines) and mergers at the regional airline level are often less well noticed. Recent examples of merger and acquisition activities in the European PSO airline sector include Finncom (acquired by Finnair 40% and Flybe 60% and now integrated into the latter), Société HOP! (regional subsidiary of Air France which was formed from the merger of Airlinair, Brit Air and Régional CAE), AEGEAN acquiring Olympic Air, Air One becoming a low cost carrier after becoming a branch of Alitalia and Livingston operating Italian PSOs instead and finally CityJet and VLM Airlines being sold to Intro Aviation and then merged with InterSky.

A desk officer at the European Commission (DG Move) helped add to our list with suggestions from their perspective, and this enabled us to close some remaining gaps and achieved a more complete view of the market participants as of April 2014.

The most difficult part of our analysis was to then identify the key account person within the airline who would also be willing to participate in our research. Although we had a good network of contacts from previous studies, because of the degree of consolidation and the generally dynamic nature of the business, some of those contacts had moved on or changed jobs within the airline. For example, the PSO manager for a large European airline who manages just one PSO route had recently left the company with no-one else now feeling confident enough to answer our questions. As the response often depends on the role, we were aiming to have the CEO/MD, the chief commercial manager or someone within a business development position responding to our survey and for a number of airlines that meant that we had several responses (which were then averaged). This was to overcome the disadvantages of not being able to conduct face to face interviews and also to account for issues related to top management heterogeneity (Priem, Lyon, and Dessm, 1999). In total we invited about 80 senior managers in 26 PSO airlines and 35 non PSO airlines to participate. We achieved a 39% response rate overall and a 56% response rate of PSO airlines currently operating in Europe (which was heartening given the sensitivities and language barriers involved in such an exercise).

As shown in Table 1, our final sample includes valid/full responses from 24 airlines from across Europe. The 14 PSO operators that have participated in our research collectively operate 65 PSO routes (as of May 2014) and have operated a total of 112 PSO routes over the last ten years. The 10 non PSO operators represent all sizes of airlines in Europe and we were satisfied that the sample was generally geographically comprehensive (responses from Greenland to Greece). In terms of airline participation we did not encounter fear of sharing sensitive information encouraged by our
reassurances about confidentiality, but it was noticeable that none of the large LCC airlines in Europe “felt in a position to contribute to our study”. The research was further informed by the previous coalface experience of one of the study authors, who participated in over twenty PSO tender submissions representing an air operator, over a twelve year period, and was successful in eight of these competitions.

Table 1: Sample of PSO and non-PSO airlines

<table>
<thead>
<tr>
<th>Country</th>
<th>PSO operators</th>
<th>Country</th>
<th>Non-PSO operators</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>2</td>
<td>England</td>
<td>3</td>
</tr>
<tr>
<td>Finland</td>
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<td>Germany</td>
<td>2</td>
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<tr>
<td>France</td>
<td>1</td>
<td>Ireland</td>
<td>1</td>
</tr>
<tr>
<td>Greece</td>
<td>1</td>
<td>Netherlands</td>
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<tr>
<td>Greenland</td>
<td>1</td>
<td>Slovenia</td>
<td>1</td>
</tr>
<tr>
<td>Iceland</td>
<td>1</td>
<td>Spain</td>
<td>1</td>
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<tr>
<td>Italy</td>
<td>2</td>
<td>Sweden</td>
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<tr>
<td>Norway</td>
<td>1</td>
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<tr>
<td>Portugal</td>
<td>1</td>
<td></td>
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<tr>
<td>Scotland</td>
<td>2</td>
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<tr>
<td>Spain</td>
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Source: Own analysis

Our survey aimed at exploring different aspects of their experience and perceptions, which it was hoped could lead to identify areas for further examination, or for improvement. A key hypothesis of our research was that language barriers would deter cross border competition for PSO contracts. In order to address the context appropriately, the survey were divided into two types – one for operators already operating PSOs, and the other for operators who do not currently operate PSOs.

For the PSO operators an attempt was made to gauge their success rate in bidding. We further asked them whether they bid internationally, and whether they found the data provided in the tender documentation adequate and how it might be improved. We probed their awareness of sources of information on European PSOs and how that might be improved. We also asked them how they thought PSO competitions were assessed and how they should be assessed. There were some questions on their trust level and working relationship with their sponsoring authority as well as their attitudes with regard to other country’s public transport authorities. A series of questions were asked about the timescales of the process and whether these were adequate and whether changes would be welcomed. We did ask some more standalone questions on whether they undertook collaborative marketing of their PSO routes with public agencies, how they sourced aircraft if they successfully bid (as this does have a bearing on timescales, cost and risk) and on the size of their subsidised/protected routes in relation to commercial routes in their portfolio.
The non PSO operators were asked a similar range of questions, but with variations exploring their reasons for not bidding, or perception about why they had not been successful in their bids. They were asked for suggestions on how PSOs could be made more open to competition and all operators were asked whether they thought that PSOs deter competition and can act as a form of market protectionism.

Several aspects should be borne in mind when interpreting the results. The range in size and sophistication of airlines is very large; from small 9 seat operations employing a handful of people to full service flag carriers. The operators, who did run PSOs, again varied in their activity levels with 12 respondents/airlines covering 97 PSO route operations over the last ten years, and of these 6 operators fulfilled 88 out of the 97 routes represented. The dynamics in the PSO market also became apparent as for example one operator went from 10 routes to one and another from 35 to seven routes during the last ten years. This results in the situation whereby some issues are best considered operator by operator, whilst others provide a different priority sequence when considered under a weighted system that ensures big PSO operators/programmes voices are heard more proportionately.

### 3. Results

When analysing the responses of the PSO operators, we found that they not only collectively had operated 112 PSO routes in the last ten years but also had undertaken 59 unsuccessful bids over the same period. However this picture of competitive dynamism is slightly countered by the fact that when their PSO success rate is worked out they range from a 33% success rate to a 100% success rate with an average of 71% (29% of respondents had a 100% success rate), which does suggest that successful PSO operators enter tender competitions with a high likelihood of success, and there are some local champions who rarely fail.

Of the ten non PSO operators who responded only three had bid for PSOs in the past ten years; all unsuccessfully. When asked would they bid for PSOs in other European countries, six of the 14 PSO operators answered in the affirmative. Eight indicated in the negative. Of those saying no, when further asked to categorise their reasoning the answers illustrated in Figure 1 emerged from the two classes of respondents.
As we can see the main inhibitor is the cost and complexity of opening and operating an additional base. Surprisingly language barriers (our key hypothesis), unattractiveness of contracts and the lack of suitable interline agreements were not even mentioned whilst the other inhibitors received single votes, apart from two operators concluding that the incumbent was too strong. However it should be noted that one substantial multi-PSO regional operator did contend that the compensation offered by the transport authority/procuring institution was not sufficient. Only three of the non PSO operators (out of ten) indicated that they would be prepared to bid in other countries, and these three were the only three non PSO respondents who have ever bid for PSOs even in their domestic market. This suggests that having negative PSO bidding experience domestically has not deterred them from considering engaging in international PSO operations in the future.

The non PSO operators’ results to the supplementary question were slightly different, as for them the additional option in not having an interline agreement at the metropolitan airport in a PSO proved to be a significant additional factor in not bidding for PSO contracts.
When asked if the data provided by the tendering authorities is sufficient, five out of 14 PSO operators and six out of the ten non PSO operators indicated that it was. Interpretation of this result is difficult, especially as practices do vary across the EU, so a simple comparison cannot be made. However it would be reasonably safe to say that satisfaction in tender information was reasonable, but improvement if decided upon, could be guided by the summary of answers from the dissatisfied as displayed in Figure 2.

Note: Measured in % share of airlines that selected the attribute in total PSO or total non PSO airlines

*Figure 2: Information that would help increasing airline participating in air PSO tenders*

Once again practices in different jurisdictions in Europe are markedly different, and incumbent PSO operators are likely to be more protective on route data than aspirants, as they may consider much of it commercially sensitive. Nevertheless each of the options offered received support from more than one operator and seasonality, revenue data and current subsidy levels were all popular options.

Of the other suggestions operators mentioned the risks surrounding a potential Transfer of Undertakings (Protection of Employment) costs, and another the desire to have the tender documentation translated into English and not just local languages, which we were surprised was an issue, even if only in this one instance. A non PSO operator felt that tenders often written already for the “winner”.
Analysing air operators’ managerial perceptions of incentives for competing for regional PSO air services within Europe
Merkert and O’Fee

It was interesting to gauge if operators monitor the European Union Official Journal for PSO or other published PSO opportunities? Nine out of the fourteen PSO operators and two out of the ten non PSO operators did so. When asked if they are aware that PSO information notices are published by DG MOVE and do they use DG MOVE’s EU PSO listing – 5 of the fourteen PSO operators and 3 out of the ten non PSO respondents answered in the affirmative. This suggests that there is industry awareness progress to be made here, and our research hopefully may be part of steps into that direction.

We then progressed to a more qualitative research section and first asked for suggestions regarding improving the utility of the PSO list for bidders. The issue that was mentioned most often was that the EC PSO list should be updated more regularly (“current one is out of date with as 2013”) and that operators should receive email notice (“subscription should be offered”) when new tenders or information are added to the last. It was also seen as useful to establish an archive of past tenders and preferred bidders and it was generally felt that the communication via aviation authorities and the European Regions Airlines Association could be improved and more designed for the actual operators’ needs. Our second qualitative question aimed to reveal how in the PSO operators’ views PSO tenders can be made more open to more competition. Interestingly (in line with Merkert and Hensher, 2013), most operators felt that the current tenders and contracts are too complicated for the type of operators interested and able to bid for them. Other than simplifying the process, improving the time scales involved (which reportedly favour incumbent airlines) and publicising the tenders as broadly as possible, there was surprisingly a shared perception among the PSO operators indicating that the current PSO tenders are appropriate for achieving competition. The non PSO operators added that they were often not informed (contacted directly) about PSO tenders and that it would be therefore useful to publish and regular updates of all PSO tenders (in all common EU languages) on the DG-MOVE website, which should include more information to assist non-local carriers in establishing the economics of a route to enable a speedy evaluation to be conducted. In this rather qualitative exploration, non-PSO operators therefore confirmed some of our hypothesis, but as shown above when asking all types of operators about language issues, it has not shown to be significant (to say the least). As expected, particularly the non-PSO operators felt that as routes are operated under PSO (tax payer) governance, such information should be in the public domain. Some North European non PSO operators even expressed disconsolantly that there is now more than sufficient competition for such contracts particularly from Eastern European operators.

We then asked them about the top three selection criteria that they consider PSO authorities use when choosing their preferred bidder (e.g. price, quality, inter-lining, financial fitness, safety, trust) and the top criteria mentioned in almost every response was price (some operators thought it was price, price
and price!) followed by quality and financial fitness. Safety and inter-lining were also mentioned but much less often than the top three.

When asked to summarise the quality of their working relationship with their main PSO managing authority 90 per cent of the respondents (when weighted by PSO routes) indicated that they had either a very good or a good relationship with their respective authority. The remaining 10 per cent selected neutral and no operator suggested a poor or very poor relationship, which is better than what we had anticipated. When PSO operators were asked if their business relationship with the principal has improved over time eight out of fourteen answered in the affirmative, which is more of a trend than expected as at the outset we hypothesised that the longer they knew each other the more they would tire of each other, but perhaps explicable by transaction cost theory. With regard to whether they trusted the PSO sponsoring authorities that their airline works with (to treat them fairly) twelve out of the fourteen respondents agreed. Seven out of the ten non PSO respondents answered an equivalent question also in the affirmative. We then applied the same trust question to other European PSO sponsoring authorities and eight out of fourteen answered in the affirmative which does represent a drop in trust in ‘foreign jurisdictions’. However some of the non positive respondents may have just been skipping a question they perceived as not relevant, rather than positively expressing distrust. We also asked if they trust European PSO authorities (also differentiated by their level of PSO operating status) that they do not currently work with that they would treat their airline fairly and the pattern shown in Figure 3 emerged. It becomes apparent the both PSO and non PSO operators have slightly more trust in Northern European PSO authorities and that Greece seems to have some issues in terms of their image with the operators from other countries.
A number of explanatory comments were also offered to the preferences indicated, with the most frequent one being that they had “No such experience with other countries”. It should also be noted that 16 of the 23 respondents could be described as northern European operators so that the lower scores for South Europe may partly be a reflection of distance and unfamiliarity. However trust in Scandinavia and the British Isles seems strongest.

To our question on whether PSOs deter competition and can act as a form of market protectionism seven out of the fourteen PSO operators responded that they agreed with the comment and eight out of the ten non PSO operators also agreed. Interpretation of this result is difficult as the question, in retrospect, combines a value judgement assessment (market protectionism is a bad thing) with a statement of fact, because most PSOs deliberately do protect the operator, because the route is thin. However unsurprisingly we can see that more non PSO operators are in some way disgruntled with a system they are not partaking in.

When PSO operators were asked to offer the top three issues they would like improved in public authority PSO contracts with brief explanations the top three comments were better incentives, risk/reward sharing and less focus on price in the selection process. Bigger contracts, more marketing collaboration as well as more flexibility in terms of equipment and schedule were also mentioned. These comments support Merkert and O’Fee’s (2013) finding that PSO sponsoring authorities need to take more interest in marketing the PSO route and need to design contracts to incentivise air operators.
to develop route revenues, and not thereby loose equivalent subsidy as a result of any such successful efforts.

There were then a series of questions concerned with the timescales of various PSO tendering processes. These issues were probed partly because the PSO regulations themselves requires a minimum six month pre-notification requirement, which one suspects was introduced without the sort of frontline research into the travails of air operators here being undertaken.

When asked how long do you need to be able to adequately prepare a PSO tender response, the responses exhibited quite a smooth bell curve centred around six weeks, as shown in Figure 4.

![Figure 4: Time needed to adequately prepare a PSO tender response (in weeks)](image)

Nine out of the fourteen PSO operators answered the generalised question regarding timescales being sufficient in the affirmative, with one adding “some are very short notice”, and there was hence no consistency. The dissatisfied respondents were given the chance to suggest a realistic timescale and three opted for eight weeks whilst one suggested six weeks. These various probings seem to suggest that quite a few operators find a four week response challenging. It could be added that this is feedback from successful PSO operators and we speculate that unsuccessful operators, or operators investigating a completely new route prefer more time. However less dissatisfaction with this tender response timescale was encountered than hypothesised by the researchers at the outset.

The interrogation then moved to the requisite preferred gear up time after award of contract and before launch. How long does your airline require after award of a new contract to successfully prepare for route launch? Apart from one respondent who answered: “contingent upon the size and scale of PSO”, the range of responses as illustrated in Figure 5 was an average of 13 weeks, with 2 operators thinking that as much as 6 months would be reasonable.
Analysing air operators’ managerial perceptions of incentives for competing for regional PSO air services within Europe
Merkert and O’Fee

Figure 5: Preferred time needed after award of a new contract to prepare for route launch (weeks)

In our experience this should give pause for thought for many transport authorities, as the current legislation permits change of common practice and we will explore this further in our conclusions.

A further aspect of the gearing up challenge asked the respondents on how they sourced the aircraft when last successful in a PSO, with the aim to better understand what challenges lay in that direction. The answers, illustrated in Figure 6, were not unsurprising, as the typical timescales do not permit fresh sourcing of ‘new’ aircraft (outside of immediate or easy access options).

Figure 6: Aircraft sources for last successful PSO bid

When asked if their PSO aircraft undertake work outside of their PSO commitments eleven out of the fourteen respondents replied affirmatively, which suggests that allocation of costs and rewards between PSO and non PSO work will be an issue between many sponsoring transport authorities and operators. Our research did not explore this potentially very interesting topic in any further depth.
Focusing again on the airline/authority relationship, we than asked how often the airline managers physically meet the principals of their various PSO route(s) each year (please note each different authority if applicable)? There appears to be a range of annual, half yearly, quarterly or monthly meeting systems in use. Overall, we could not establish a clear trend in what would be an appropriate frequency for face to face meetings (and the cost benefit of more or less regular meetings, or meeting substitutes).

Our previous PSO research suggested that sponsoring authorities should take more interest in route promotion and marketing and prompted this question – “Do you undertake collaborative marketing of the PSO route(s) with other stakeholders – provide examples of cooperation?” Predictably only four offered some positive response and these comments were: a) codeshare scheme between parent company and subsidiary, b) airports and local media, c) marketing with sponsoring city and d) current PSO sponsor. If we discount the first answer as not amounting to collaborative marketing with the sponsoring authority we can see that only three out of fourteen or 21% are involved in some sort of partnership marketing. In fact when we consider this by number of current PSO routes we can see that only three out of the 65 current routes represented by our sample or 4.5% of routes are covered by such collaborative marketing. This is very much in line with our discovery from previous research that few sponsoring authorities stipulate marketing in their PSO contracts, or use it in any systematic way to assess the quality of bids. Worse still the way many PSO contracts are constructed the airline receives no benefit from successful marketing, as additional yield will reduce their subsidy accordingly. To our knowledge no PSO has ever escaped the PSO designation and become open market and self-funding. This common oversight may be one reason for this state of affairs, which in our view leaves room for improvement and prompts policy suggestions which are discussed in the following section.

We finally asked the airline managers how many of their PSO contracts are open PSOs (more than one operator can fulfil) and only two operators representing only eight PSO routes answered in the affirmative. When asked if their PSOs received subsidy, most PSOs, apart from some routes in Italy, France and Norway appear to. Nearly all the PSOs apart from some in Portugal and Spain are restricted to one operator, which is the most popular interpretation and application of the PSO regulations.
4. Conclusions and policy/strategy recommendations

This paper set out to establish evidence on why airlines engage or do not engage in PSO bidding and operating activities, particularly across borders, as this might illustrate barriers to healthy competition and market efficiency. We identified a number of deterrents for PSO operators not to go abroad (the main reasons being the cost and risk of developing additional bases and for non PSO operators not having the right equipment or interline agreements) and participate in PSO tenders, but also found evidence that issues such as language mattered substantially less than expected. Our key hypothesis was that language/culture barriers were a significant deterrent for cross-border PSO contract bidding and although language per se was not seen as a barrier, there were some indications that culture was although much less than expected still of a slight concern to some operators (culture issues in the sense of a fear of different legal systems and practices, employment law, contract law, local favouritism, making money of foreign operator with different charges etc.). While there still appears a lack of competition for PSO contracts some operators felt that the level of competition is already very intense (in terms of cost pressures) on some routes, particularly where (East) European operators with a lower cost base bid on West European routes. Also trust levels, particularly in regards to PSO authorities based in north European countries, are higher than initially speculated by the researchers, as are working relationships once a PSO operator enters a contract.

Based on our findings we derived the following recommendations to the various stakeholders, which in combination have the potential (at least in our view) to better facilitate the single market and promote competition and cross border activity within the EU regional aviation market.

**Air operators** can better avail themselves of the PSO information that is available via DG-MOVE and the EU Journal, and can register with DG-MOVE to receive their weekly newsletter which highlights PSO tenders. Airline managers should approach and enter into dialogue with identified PSO sponsoring authorities well in advance of any invitation to tender. This allows them to gather data and intelligence of the route outside of the strictures of the formal tender process, and it also allows them to assess the authority’s interest in, or appetite for, new bidders in forthcoming tenders.

**PSO Sponsoring Authorities** should extend the lead time of their PSO tender competitions.

As explored in this paper the timescales for typical PSOs are very, very tight. As section 4 of Article 16 of Regulation (EC) No 1008/2008 states;

“The Commission shall make the invitation to tender known through an information notice published in the Official Journal of the European Union. The deadline for submission of tenders shall not be earlier than two months after the day of publication of such an information notice. In case the tender concerns a route to which
the access had already been limited to one carrier in accordance with Article 16(9), the invitation to tender will be published at least six months before the start of the new concession in order to assess the continued necessity of the restricted access.”

<table>
<thead>
<tr>
<th>Project Task</th>
<th>Pre-launch time indication</th>
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<tr>
<td>2. Tender response period</td>
<td>2 months</td>
</tr>
<tr>
<td>3. Tender evaluation Period</td>
<td>1 month</td>
</tr>
<tr>
<td>4. Tender award - pause for any appeals</td>
<td>2 weeks</td>
</tr>
<tr>
<td>5. Contract signing</td>
<td>At best ten weeks before launch</td>
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As we can appreciate there is no room for slippage and a 10 week lead time is the best that is possible under the scenario outlined above. It seems to us that this tight timescale strongly favours the incumbent and inhibits competition. There is one obvious and easy response. Sponsoring authorities should be reminded that the phrase “the invitation to tender will be published at least six months before the start of the new concession” provides them with an opportunity to publish their invitation to tender (ITT) with times greater than six months. Most authorities treat the six month publication deadline as the norm or target, rather than the minimum. Air operators, particularly aspiring new route air operators, consider six months as very tight.

The PSO authorities should further proactively canvas air operators about their forthcoming tender competitions. The list of EU operators in not endless and is even shorter when route-suitable aircraft types are considered. The PSO authority should also provide comprehensive data in their tender documentation to aid new entrants in their calculations and tender preparations. Indeed the balance between the commercially sensitive information of the current operator and information that ‘belongs’ to the route, which is the ultimate responsibility of the sponsoring authority, could often be moved. We would suggest that the authority develops KPIs for the route, which should include key route data, and these reports should be summarised in the ITT. We see no reason why seasonal data, total route revenue data, freight revenue data, historic route data, route reliability and punctuality data, and average occupancy on different flights during the week are not all made available. The airline arguably can retain confidentiality over its specific yield management strategy (variable ticket pricing). The sponsoring authority should further consider whether its supervision of the PSO route is optimal. This research only touched upon this issue, but generally indicates wide variation in the levels of supervision, but with no real understanding of any variability in its efficacy.
As setting up a new base has been identified as a major inhibition for potential bidders the sponsoring authority should consider strategies to reduce the perception of difficulty in this regard. The obvious device of including the relevant contact at each airport with their contact details in the ITT is a simple and easy step. One of the authors of this paper was involved with a client (albeit in a non PSO circumstance) where a local liaison person was appointed to help the airline source local crew accommodation, sort out hangar arrangements and be introduced to airport management and handling agents. This sort of familiarisation effort could help reduce real and perceived barriers to new base development.

Critically, the PSO authorities should develop a tender contract that truly values marketing and rewards success in building the route. This aspect was picked up in earlier research into transport authorities’ practice (Merkert & O’Fee, 2013) and has been validated in mirror image by the results from the air operators. The challenge is to lift patronage and revenue on the routes in question and if the local authority does not take an interest, why should the airline, especially as many contracts do not reward them for doing so.

Additionally tender assessment criteria should be developed to more consciously and prominently reward superior marketing plans. The PSO contracts developed should share rewards and risk equitably. Our previous research (Merkert & O’Fee, 2013) has shown that clear and powerful incentives need to be created for the operator to innovate and develop the PSO route. The key to unlocking innovation is to allow the operator to keep some, or arguably all, of any additional revenue generated by such marketing activities in the current tender round. This is where operators’ and authorities’ views differ the most (when comparing the results of our two papers). However, the buyer can take the view that once any advances in revenue become embedded on the route the authority will enjoy reduced subsidy requests in future tender rounds.

At the higher, supranational level, DG-MOVE could compile and perhaps more importantly frequently update a list of contact points for all EU operators and permit PSO sponsoring authorities to use that list to contact air operators directly (while the former is a view shared by operators and PSO authorities, the latter was unsurprisingly only of importance to the operators). The list should include key profiling data such as aircraft types operated and size of fleet, and be summarised in a way that is easy to understand for non-aviation specialists such as the sponsoring authority often have in post. DG-MOVE could further improve the efficacy of its PSO listing in ways indicated by this research. Indeed we would suggest that DG-MOVE sees their PSO listing as not only delivering EU wide transparency on the PSO system, but as a means to cultivate the single market in this domain by more consciously serving the needs of the operators. DG-MOVE could also facilitate sponsoring PSO...
authority gatherings to cultivate and disseminate best PSO practice. There should be a legal dimension to any collective networking, as there is wide variation of interpretation within the EU of what is, and is not, permissible under the same regulations (Merkert & O’Fee, 2013). Finally, DG-MOVE should consider facilitating some sort of gathering for both sponsoring authorities and air operators – e.g. a biennial conference, where authorities could present on their upcoming needs, and airlines could interact with them. Our research has shown that authorities and operators are often similar in their views and that they share the common aim to support and grow air transport to regional and remote areas. It is in many cases just the appropriate facilitation of information and engagement of operators that limits the (cross-border) competition for PSO contracts. There may of course be electronic ways to facilitate some of this communication and networking via automated alerts and emails that may be worth exploring.

While we are confident in our findings it is worth mentioning a couple of limitations. Firstly, although having good coverage, we have not managed to get responses from all PSO and non-PSO airlines. Secondly, the named contact who responded to the survey did not always hold the same role in the company and their views may well be both a mixture of their personal perspective and the corporate view. Both aspects leave scope for further research which should also focus on changes of perceptions, attitudes and relationship (i.e. levels of trust) over time as not only the regulatory framework but also PSO airline markets change (i.e. mature and consolidate). Further research would also be beneficial in the area of best and permissible practice with regard to PSO route marketing. Discussion and research could fruitfully be had on what levels of route information are appropriate and reasonable for inclusion in ITT to ensure transparency is maximised.

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Merkert and O’Fee