SENEM ACET COSKUN
BUS 9200 - FALL 2008

The Competitive Environment of the US Domestic Airlines Industry

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Since deregulation in 1978, the U.S. domestic airline industry has undergone a significant change. While the industry was running with an inefficient system in which airlines was acting as near monopolies before, deregulation made the industry open to unrestricted competition and started a new era where industry overcapacity, strong competition and severe price wars were dominant. Many disadvantages due to deregulation caused low entry barriers and so an increase in new entrants which brought different approaches to industry needs. New entries have forced incumbents to strengthen their position through acquisition. As a result, the industry is now shared by six big networks (%51 market share), nine low cost carriers (%30 market share) and 16 regional carriers.

When the industry is analyzed according to Five Forces Model, internal rivalry within the industry seems the most important force especially since the market is completely saturated. There are more service providers than needed in the market. Airlines are basically competing for the same customer, resulting stronger buyer power. The airlines are continually competing against each other in terms of prices, technology, in-flight entertainment, customer services and many more areas, which creates quality differentiators and cost leaders in the market.

Another most obvious pressure comes from “new entrants”. In 1978, deregulation created high entry barriers where it’s nearly impossible for a new entrant to survive. With the hub-and-spoke system, the powerful carriers had high capacity utilization where the revenue increases reduced the cost per seat mil flown and thus playing a critical factor in airline’s profitability. However, disadvantages of hub-and-spoke system also played an important role to make new entrants bring point-to-point system as an alternative. The new system eliminated the huge investment requirements for hubs, reduced the flight turnaround time and allowed the use of single standard aircraft that minimized pilot training and maintenance. And thus it allowed too many new entries, meaning too many competitors. This trend led existing airlines to strengthen their positions with mergers. As a result, we can say that the industry itself created a way for new entries and it’s very possible to see another carrying system with even higher load factor, which may leave some airlines out of picture.

Another strong pressure comes from customers as “buyers”. Passengers use airline travel for two kinds of reasons, business and leisure. These two kinds of travels have different functions and so different needs. Leisure travel in the US is estimated at %60 of the total air travel, where the remaining %40 belongs to the business travel. Leisure travelers are more sensitive to price changes since they can change travel plans to find lower fares. They can wait to see the discount offers to make the purchase. On the other hand, business travelers have less flexibility in their travel plans and hence they are less sensitive to price. However, they are looking for comfort and quality in service while they are traveling. Loyalty is hard to maintain. Travelers may switch from one airline to another as soon as they find the same service for a lower cost. And sometimes even the service may not be so important, as long as the price is significantly low. Absence of switching costs, the advantages of internet to look for the lowest price among all alternatives and always existing low cost substitutes such as cars, trains and videoconferencing give a high bargaining power to buyers.

Another force, suppliers, has a lower pressure than new entrants and buyers. Aircrafts are expensive items and they can not be bought and/or replaced every other year. The rivalry between aircraft manufacturers is high enough to cause a lower pressure to airline industry. Jet fuel, on the other hand, plays an important and critical factor for the profitability of the industry. In order to increase fuel efficiency, aircraft manufacturers perform restructuring on an aircrafts.

Airline industry shows a challenging pattern for new entrants and it also seems to have costly investment requirements. It’s for sure that as customers’ willingness to pay increases so does the profitability. As time becomes more and more important, the strong time efficiency that comes with flying increases the willingness to pay. Airlines must be cost effective and have quality service to be able to stay in the business. “Time is money, money is time” approach should be used while making service and price optimization.