

Drivers of competitive actions and responses



The Airlines Industry: a background

The commercial airline industry is regarded as one of the most difficult and competitive in the world. Competition in the aircraft industry has attracted attention not just because of the controversy surrounding subsidies that are often needed to cover up the huge losses that companies have been making in this sector, but because of the industry's unusual structure. The aerospace industry is replete with examples of industries where governments have used trade policy to alter the strategic interaction between competing firms in the airlines sector.

During its early days, the industry was characterised by competition among a large number of sophisticated, entrepreneurial firms. Survival risk was low because of guaranteed access to national airlines and a rapidly expanding market. Technological advances were often financed by states in deference to their defence industries. Since WWII, however, the industry has transformed into an oligopolistic production structure, extremely high survival risks, and intense competition for sales in a global market

Technological advances have extended development lead times, increased launch costs, complicated marketing, and lengthened the time between initial research and revenue earning. Probably no other industry in the world is as global as the commercial aircraft industry. The process of manufacturing an aircraft is very complicated and thousands of parts and are needed for the development and manufacturing of a plane. The high costs associated with the development, design and construction of an aircraft as well as the fierce competition between the two main players

forces them to seek into finding ways to lowering their costs. In order to do, players like Airbus and Boeing try to build their competitive advantage by achieving global efficiency, multinational flexibility and worldwide learning.

Some key distinguishing characters of the airline industry can be summed up as:

The seeming departure from the efficient industry theory in case of airlines industry: The efficient industry theory suggests that if an industry looks particularly attractive, then companies will seek entry, while unattractive industries will see more companies leaving. Surprisingly, even due to heavy losses, the airlines industries have not seen many companies closing down.

The reason can be attributed to the fact that the efficient industry theory often does not take into account the role of governments in industries which they consider strategic; the huge numbers of people who would be affected in case of any problem in the US aircraft manufacturing industry makes state support a necessity, affecting the attractiveness and number of companies exiting.

In their battle for survival, the airlines have sought to optimise many of the factors to improve their profitability. To enhance revenue, several airlines have withdrawn from their most intensely competitive routes; others have sought to achieve a fare premium over the cut-price airlines through superior punctuality, convenience, comfort, and services. To improve load factors, companies have become more flexible in their pricing and in allocating different planes to different routes. Most notably, companies have sought to

cut costs by increasing employee productivity, reducing overhead, sharing services with other airlines, and reducing salaries and benefits.

Company overview

Boeing:

Boeing is a leading aerospace company that manufactures both commercial as well as military aircrafts along with missiles, rocket engines, satellite launch vehicles, electronic and defence systems, and advanced information systems. It was found by William E. Boeing and George Conrad Westervelt on July 15, 1916 under the name Pacific Aero Products Company. The first plane they developed was a twin-float seaplane called the B&W, named after the developers' initials.[1]The company developed its first commercial aircraft to fly mail for the U. S. Postal Service in 1927 with the Model 40. However, the company truly saw revolution in form of the World War II after which the aircraft production surged. Boeing's first commercial jet airliner, the 707, came into service in 1958 with the 727, the 737 (for short-range travel), and the 747 jumbo jet (for long-range, high passenger or high payload flights) soon following in the decade. By 1996, Boeing's family had expanded to include the 757, the 767, and the 777, as well as updated versions of all its previous planes.[2]The full range of commercial planes of Boeing is enlisted in exhibit 1.

Boeing recorded revenues of \$64.3 billion in 2010 with a net income of \$3.3 billion.[3]It used to be the market leader before 2007, after which its position was captured by Airbus.

More specifically, in the last 10 years (1999-2008) Airbus received a total of 6, 378 orders and delivered 3, 606 aircrafts[4], whereas Boeing received 6, 140 orders and delivered 4, 089 aircrafts.[5]The first mover's advantage has played a significant role in the case of Boeing; whose aircrafts still outnumber airbus's primarily because Boeing has been in the market since 1958 whereas airbus entered the market in the 70's.

Boeing operates as a global company with centralized decision making. Its business level strategy is to maintain its cost effectiveness which is the source of its core competency. It looks for the most efficient and cost effective labour worldwide and aims at developing the best manufacturing capabilities. It has presence in 145 countries with its headquarters in Chicago.[6]Boeing focuses on large scale integration and believes in maintaining long term strategic relationships with all countries that it operates in.

Airbus:

Till the mid 60s the commercial aviation industry was dominated by American firms such as Boeing and McDonnell Douglas. The other minor European firms that existed were incapable of exerting any significant influence on the industry. These European firms slowly understood that in order to acquire any real market power they would have to form a consortium and act cooperatively. This is how Airbus was officially created in 1970 which was a consortium between France's Aerospatiale and Germany's Deutsche Airbus.

The companies collaborated in creating the A300, the first Airbus aircraft and also the first twin-engine wide body airliner. It was designed to “ fill a gap in the market and to challenge American supremacy in the aviation industry.”[7]

Slowly as new members joined in, the power of Airbus was growing. With the release of A320 in 1981, Airbus’s position as a major industry competitor was secured. Over the next two decades, Airbus expanded to include the A300/310 family, the A320 family, and the A330/340 family. In 2001, partially in order to be more efficient, productive, and competitive, and partially to prepare for the development of the A380, Airbus Industrie became a single, private company.

Even though as of now it has more market share than Boeing, Airbus witnessed a period of continued losses which it managed to partially recover in 2010. Airbus manufactures and sells A300/A310, A320, A330/A340, A350 and A380 family aircrafts. The full range of commercial aircrafts that the company manufactures can be found in exhibit 2.

Airbus operates in a centralised hub, trying to get cost advantage and quality assurances. Since the assembly requires development of many parts, the manufacturing takes place in various locations worldwide and the parts are finally assembled in Germany.[8]

Competitive Rivalry: the concept

Competitive rivalry is one of Porter’s five forces. This term describes the intensity of competition between existing players (companies) in an industry.

Low barriers to entry lead to a high competitive rivalry. If it is easy for customers to move to substitute products for example from coke to water then again rivalry will be high. Not all industries are equally competitive. In general, some of the factors leading to high and low competitive rivalry can be stated as:

Factors leading to high competitive rivalry

Factors leading to low competitive rivalry

Low differentiation between products

High differentiation hence leading to brand loyalty

Competitors are of around the same size

Some firms dominate the market

Competitors have similar strategies

Varied strategies, hence independent of each other

High exit barriers

Low exit barriers

Low market growth rates

Market can accommodate competitors (high growth)

High fixed or storage costs

Low fixed costs/ resources are not specific

High “ strategic stakes” tied up in capital equipment, research or marketing

The business is strategically less important

These are just some of the conditions in which competitive rivalry is more likely to be high. The result of this is a pressure on prices, margins, and hence, on profitability for every single company in the industry. The competitive rivalry in business occurs in so many ways but they mostly depend upon the type of customers, the size of the business, the strategies involved and the costs. In addition, there are many reasons why there is business competition and one of which is that it is expensive to leave the industry that they are in right now. In this case, they have no choice but to fight against one another in order to see which one stays on top. Business rivalry threats cannot be avoided but if you are well prepared and you have the right attitude towards them, you will be able to eliminate your rivals eventually. A series of competitive actions and competitive responses among firms competing within a particular industry leads to what is known as competitive dynamics. Factors affecting competitive dynamics can be represented by:

A Model of Competitive Rivalry

This model shows that for a firm to be able to attack or respond and hence demonstrate competitive rivalry, it needs to first be aware about the competitors; have the motivation to respond/attack and then also have the necessary resources to execute their plan of actions.[9]Moreover, smaller firms are more nimble and hence more responsive when compared to bigger firms.

Firms with high market commonality and highly similar resources are direct and mutually acknowledged competitors. However, direct rivals do not always intensify their competition. The drivers of competitive behavior, as well as the likelihood that a competitor will initiate competitive actions or reactions influences the intensity of rivalry, even for direct competitors.

Two important drivers of competitive actions and responses are market commonality and resource similarity. Market Commonality is concerned with the number of markets with which the firm and a competitor are jointly involved and the degree of importance of the individual markets to each. Resource Similarity is the extent to which the firm's resources are comparable to a rival's in terms of both type and amount. Firms with similar types and amounts of resources tend to have similar strengths and weaknesses and use similar strategies. Also Competitors are more likely to respond to strategic and tactical actions taken by market leaders. Hence reputation is also a key determinant of the extent of competitive rivalry.

Market Commonality

Boeing and Airbus compete in 6 main geographic regions in two broad product categories – narrow body and wide body aircrafts¹⁰

North America

Europe

Asia Pacific

Latin America

Middle East

Africa

Narrow body aircrafts are used for up to 6,000km and carry between 100 and 200 passengers whereas wide body aircrafts are used for up to 14,000km and carry 200 to 450 passengers[10].

Historically Boeing had dominated the market share in each of the regions and categories. This is possibly due to the fact that it had the first mover advantage and hence a longer presence in the industry. Also the fact that commercial aircrafts have an average life span of about 30 years contributes to this dominant market share of Boeing. In the last 10 years however, the two companies had about the same share of orders and deliveries. However with regard to the net order share, in the last ten years, Airbus has overtaken Boeing in the race with 64% market share while Boeing is left with only 36% as of in the year 2009. This is in contrast to the fact that Boeing occupied 54% market share as compared to 46% by Airbus in 2000.

In fact Boeing and Airbus capture about 92% share of the world commercial aircraft market in narrow body and wide body aircrafts.[11]

In Asia, Airbus has two subsidiaries namely Airbus Japan and Airbus China. Since the Asia market is of strategic importance the two subsidiaries there carry out marketing and sales activities and also foster greater industrial cooperation with companies in the Asia-Pacific regions. Similarly, the Airbus Russia subsidiary offers its services to Aeroflot, Russia's international airline operator[12].

Again Boeing has been actively involved in the international market and especially in the Asia-Pacific region. In Japan, Boeing has offered longstanding relationships with Japanese suppliers including Mitsubishi Heavy Industries and Kawasaki Heavy Industries by which these companies have had increasing involvement on successive Boeing jet programs. This process has helped Boeing achieve almost total dominance of the Japanese markets for commercial aircrafts.

Again when it comes to product portfolio both the companies have similar portfolios with the products being direct competitors in different categories. In 1970 Boeing launched the world's largest passenger aircraft, the famous B747. Since then, Boeing enjoyed a monopoly in the market for large passenger aircrafts. In 2001, EADS Airbus attacked this monopoly by launching the A380, which is now the largest passenger aircraft with more than 550 seats. The launch of the A380 programme actually pushed Boeing into the position of challenger. Boeing responded by launching the B747X, an extended version of the B747. However despite a heavy marketing effort in the beginning of 2001, Boeing did not have the same success with its 747X. Given the segment's slim size, Boeing had to withdraw from the race and instead created another niche in which it started to compete. In April 2001, Boeing launched the Sonic Cruiser, which not only had a new design with canards and delta wings, but also signalled a very different strategic approach to the market.

In the 100-seat market Airbus's A318 is a direct competitor to Boeing's B717. Likewise A321 competed directly with B757 in the 240-280 passenger categories. Again in the wide-body, long-range, 200-400 seat market the

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Boeing 767 and 777 families, compete with the Airbus A300, A310, A330, and A340 families. All of these aircraft families are intricately intertwined in market relations and competition[13].

Over the years the two companies have come out with fundamentally different products, based on diametrically opposite visions of the future. The A380 is built around the assumption that airlines will continue to fly smaller planes on shorter routes into a few large hubs, then onward to the next hub on giant airplanes. It assumes that passengers will put up with the hassles of changing planes in exchange for the privilege of travelling in a jet-powered cruise liner. Boeing however challenges the current hub-and-spoke model as a given and believes customers still prefer more point-to-point flights, flown more frequently, on smaller airplanes.

Resource Similarity

Strategy is concerned with matching company's resources and capabilities to the opportunities that arise in the external environment. Airbus' main goal is to meet the needs of airlines and operators by producing the most modern and comprehensive aircraft family on the market. This in turn is complemented by the highest standard of product support. Airbus produces aircraft which are unique in its design and uses high end technology installing fly-by-wire, cockpit commonality design and other innovative designs attracting orders from its customers. At the same time Airbus also manufactures products suiting to the needs of military with use of advanced technology. The capability of Airbus lies in manufacturing aircrafts which are unique in design and are advanced on the technological aspect as compared to its rivals. The capabilities of Airbus arise from its valued resources like <https://assignbuster.com/drivers-of-competitive-actions-and-responses/>

culturally diverse employees, its customers, contractors, suppliers whom it considers as partners and develops new aircraft only in consultation with its customers. The resources and capabilities have resulted in a sustained competitive advantage over its rival in terms of technology and design. The strong organizational structure and the work culture, defined by the Airbusway[14], of Airbus have actually helped the company in becoming the industry leader and pushing Boeing to the role of the challenger.

Innovation has been a primary driver in Airbus' decades of success and has guided many aspects of the company's business activities and playing a crucial role in the development of new-generation products, processes and techniques. Airbus has over 3, 000 individuals working directly or indirectly on more than 400 research and technology projects. The A300 made the most extensive use of composite materials and by automating the flight engineer's functions it became the first large commercial jet to have a two-man flight crew. Again in the 1980s Airbus was the first to introduce digital fly-by-wire controls into an airliner – the A320.

Like Airbus, Boeing too emphasizes marketplace insight as the core of product development. Technological innovation pursued at the Boeing Technology Services goes into the making of most of newly designed, fuel-efficient twin engines and lightweight composite materials. According to Boeing, the 787 is the result of over a decade of focus groups and scientific studies to gain a better understanding of passenger comfort and how the design of airplane interiors can make flying a more pleasant experience. Approximately 1. 5% of Boeing employees are in the Technical Fellowship[15]program, a program through which the top engineers and <https://assignbuster.com/drivers-of-competitive-actions-and-responses/>

scientists set technical direction for the company. Boeing believes that having diverse employees, business partners and community relationships is vital to creating advanced aerospace products and services. However, Boeing's lost market share has often been attributed to its poor corporate strategy and decision-making and the vulnerability of a notoriously long-term business to rampant shareholder value.

Thus on the basis of market commonality and resource similarity one can conclude that Airbus and Boeing have both high market commonality as well as high resource similarity. As a result the two firms are direct and mutually acknowledged competitors and use their similar resource portfolio to compete against each other in markets that are important to them.

Drivers of Competitive Actions and Responses

Awareness

As the market commonality and resource similarity is high, Airbus and Boeing recognize the fact the degree of mutual interdependence is high for both the firms. Both the firms are acutely aware of each other's competitive actions and responses. And the rivalry is intense. The Asia-Pacific market is considered to be the most profitable market in the near future and it will be very significant as to which of the companies captures the majority of world market share in the future. As both companies have equal market share in the last few years, any potential move by Airbus will be countered by Boeing. Similar is the case in North America which is the largest market of commercial markets. It is significant for both companies, but more for Boeing which considers the market to be its home market.

The European market is the third largest market and it is highly profitable and significant for both companies. Airbus enjoys an advantage because of its cultural heritage but Boeing is a strong competitor in this market as well.

Motivation

Motivation is essentially the incentive for a firm to take action or respond to a competitor's attack. This in turn depends on the perceived gains and losses. Now Airbus enjoys an advantage in marketing and sales activities for the Asian region because of its local subsidiaries in China and Japan[16]. However, Boeing has tighter and better relations with governments. As the Asia-Pacific market involves high strategic stakes both the firms will be motivated to protect their positions through competitive actions and responses.

On the other hand as the North American region is more critical to Boeing's revenues it will have higher motivation to launch strategic moves to defend its position here. Similar is the case for Airbus in Europe where it enjoys a slightly better position. Airbus will have higher motivation to consolidate its position in Europe through competitive actions and responses.

Ability

The ability of a firm to respond to a competitor's actions or attack a competitor is related to a firm's resources. As both the firms have very similar resources any competitive action is taken only after a careful study of the possible response of the competitor is done. However as pointed out earlier, Airbus enjoys a slight better position in Europe whereas North

America is the home market for Boeing. Hence in these two regions the two firms enjoy slight advantage over each other in terms of resources.

History of the Rivalry

This rivalry started in the early 1970s with AIRBUS positioned as a viable alternative to BOEING with the help of substantial financial help from the European governments. Soon, AIRBUS was engaged in a fierce competition with BOEING in several markets across the globe. As is natural in such cases, this struggle was characterized by legal disputes, agreements, alleged violations and ever increasing complexity in the relationship that these two behemoths have come to share.

The intensity of the involvement of the Governments on both sides has added a further dimension to this rivalry.

Another interesting feature about this phenomenon was the background in which it has been played out. The relatively unique market structure of the Aircraft Industry, where the huge Economies of Scale vis-à-vis the market demand make it a highly complex environment to operate in, suggesting an overwhelming reliance on Long Term Strategy for achieving any kind of sustainable success.

The continued subsidies available to AIRBUS from the Governments of Europe have been one of the major points of contention and the basis of recurring trade disputes between the two strategic competitors. In short, strategic trade policies have been a frequently used tool on both sides of the Atlantic.

Boeing – Boeing ventured into the commercial aviation sector first in 1958 with the 707, its first commercial jet airliner. The following decade saw a spate of new models from its stables including the 727, the 737 for short hauls, and the 747 jumbo jet for long-range, high capacity flights.

During this period, the competition consisted of several small European firms, which were finding it increasingly difficult to thrive in such an environment. They realized the need to unite against the common threat and hence formed a consortium in 1970 that came to be known as the Airbus Industrie. Initially, Airbus tried to “ fill a gap in the market” by introducing the A300, its first aircraft. However, it gained little traction in the market, with the high entry barriers proving tough to overcome.

However, with an increasing number of national firms from Europe joining Airbus, and the additional resources that it enjoyed in terms of strong financial backing from the various governments, Airbus’s market power began to grow, its order book swelling at an ever increasing pace. The turning point however came in 1981, with the launch of the Airbus A320, which finally established Airbus as a major competitor in the industry.

In the next two decades till 2000, both the competitors focussed on expanding their product portfolios. Boeing had added the 757, the 767, and the 777 to its line-up while at the same time upgrading all its existing models as well. Airbus had similarly introduced the A300/310 family, the A320 family, and the A330/340 family. In 2003, Airbus delivered more aircraft than Boeing for the first time ever.

A Classic Case of Game Theory

In the 1990s, Boeing and Airbus attempted to collaborate on creating a superjumbo jet capable of carrying 500-1000 passengers.

They were brought together by their common views on the need of such an aircraft to tackle congestion.

The other, stronger factor was the realization that there was room in the market for only one player. The strategic interdependence in this case was deep. If both players developed their own VLA (Very Large Aircraft), both would incur huge losses, besides Boeing's 747 coming under pressure as well.

However, by 1995, the collaboration had ended, with many alleging that it was all just part of a strategy on part of Boeing to stall the market and delay Airbus from developing anything itself.

Airbus decided to continue pursuing the VLA project, holding on to the path of developing the superjumbo jet, subsequently to be christened the A380. By 1999, it had firmed up plans to build a family of VLA, with capacity ranging from 555 to 990 passengers.

Boeing, after breaking off, indicated that it would develop updated and “stretched” versions of its 747 jumbo jet. But it cancelled the development effort in 1997. However, in 1999, it changed tack again, saying it would build a stretch jumbo that would be available ahead of Airbus's A380.

By 2000, with a number of advance orders in the pipeline, Airbus officially launched the new plane. This led to Boeing stopping its development of its

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stretch jumbo in 2001, and a simultaneous beginning of the development of a new aircraft known as the Sonic Cruiser, which would be faster, quieter and fly higher than existing aircraft, while being significantly smaller than the stretch jumbo. This too was abandoned in 2002 in favour of the slower, but even more fuel efficient 787 “ Dreamliner”, which has, of late, tilted the balance back in Boeing’s favour.

Competitive Actions and Responses

Boeing and Airbus have engaged in a long drawn competitive rivalry on various fronts and using different strategies.

FIRST MOVER/ SECOND MOVER –

In this particular rivalry, Boeing, for long, held the First Mover’s advantage. Founded in 1916, it has forayed into Defence, Space Security as also into Commercial Airplanes in 1958. By the time Airbus entered in the 1970s, Boeing enjoyed a monopoly in the Commercial Aircraft industry. It has repeatedly bolstered its competitive advantage by relying heavily on the First Mover’s Advantage. Instances of this include the development and launch of the 707 (1957-58), USA’s first commercial jet, the 747 (1969), which became the first wide-body commercial plane and remained the only significant jumbo jet for decades, and lately, the 787 “ Dreamliner”, the first jet to make use of revolutionary technologies like light weight composites and the integrated fuselage design.

Airbus, on the other hand, relied less on the First Mover’s Advantage and more on filling the gaps left behind by Boeing initially, and later on launching products that, on some level, were based on addressing the perceived

weaknesses of Boeing's products. The A300 is an example of the former strategy, whereas the A380, though innovative in many ways, and not strictly an imitation, was targeted at doing what the 747 did, only better. Airbus, as compared to Boeing, could be classified as the second mover.

Now, since the market itself was a slow cycle market, with each advance and change in technology taking a long time to fructify, Boeing was not wildly successful with its First Mover's Advantage. The last two decades of the 20th century saw Airbus make deep inroads into Boeing's territory, finally overtaking it in 2003. Its own gamble with the A380 has however jeopardized its position again. It was entering into uncharted waters for the first time, and faced numerous glitches. It was Airbus's first effort at bringing out something revolutionary (by its standards), and it seemed to have not met the expectations of the manufacturer. Thus, the industry does not seem to have favoured the First Mover as much as some other Fast Cycle Markets would have. The 787 seems to be an exception, but that has yet to be tested against upcoming competitors like the A350.

Size

Size has always been a huge factor in this rivalry. This industry is highly capital intensive, with massive costs of development and production. Also, size has had its advantage in terms of creating and exploiting additional synergies in terms of sharing resources like expertise and technology sharing. The economies of scale relative to market demand are so high that small players cannot exist in such an environment. Airbus spent \$12 billion before its first flight in 2005. Similarly, the 787 is estimated to have cost Boeing over \$10 billion in pure development costs alone. It generally takes a

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decade before a firm can hope to recover such costs through sales, and that only if the model is successful. Several smaller player with lesser resources have either ceased to exist or been taken over.

Recognizing this very fact, the various constituent members of Airbus came together to form the consortium and take the fight to Boeing, which always ha