A swot analysis of american airlines tourism essay

Environment, Air

INTRODUCTION:

American Airlines was the U. S.'s largest carrier in 1992. It had a fleet of 622 jet aircraft, flying 2, 450 flights daily to 182 locations. It also had innovative technology and programs. They were the first to introduce a computerized airline reservation system called Sabre, ' Super Saver' fares and frequent-flier programs. Despite these innovations, American Airlines and the airline industry as a whole was still not operating as profitably or providing customer satisfaction the way it should in 1992. There were two main reasons. First, the airline industry was suffering from the economic downturns in 1990 and 1991. In 1991 alone, the industry's cumulative losses were $1. 87 billion, which exceeded the total amount of profits the industry had ever earned throughout its 60-year history. American Airlines itself reported losses of $77 million in 1990 and $165 million in 1991. In terms of customer's flying, the dollar volume of pleasure travel grew only 8% in the 1989-91 period compared to 19% for 1987-89. The comparable figures for business travel were a 9% increase for 1989-91 in contrast to 28% growth experiences in 1987-89.

April 9th, 1992 American Airlines announced that their yields were too low and they were going to bring value back to air travel through a new pricing strategy termed, ' Value Pricing'.

SWOT ANALYSIS:

Strengths

Market leader: American Airlines is the largest U. S. airline in 1992 with a 19. 15 market share in 2001.

Strong Innovation

Technology: American Airlines created the first and largest Computer Reservation Service, SABRE, which was a valuable resource for yield management and extra profits. It was such an effective technological innovation that in 1992, 92% of domestic reservations were made through Computer Reservation Systems in the United States.

Marketing Promotions: American Airlines were the first to create a frequent flier program aimed to increase brand loyalty with business customers in 1981.

Distribution: The use of hubs meant replacing non-stop flights with a set of connecting flights, and this benefited both carriers and consumers. Airlines could serve more locations with fewer planes. American Airlines benefited by having six hubs in 1992, two of which are ranked as the largest airports in America: Chicago and Dallas.

Market Growth: Between 1981 and 1991, passenger volume grew by almost 80%, the equivalent of a compound annual growth rate of 6%. There are still opportunity gaps to further increase demand.

Strong Brand Image: A survey that generated the ratings of domestic airlines on service quality, American Airlines had the joint highest satisfaction index of 76. This implies that American Airlines has a stronger image of high quality service, relative to competitors.

Problems:

There are high risks of delays and inbound flight delays of even a few will inevitably delay connecting flights and then affect large portions of the network thereafter.

Enormous transaction costs from the extreme complexity of capacity planning, crew roistering, flight scheduling, ground handling and fare structures.

High risk of missed connections and lost luggage with connecting flights

Opportunity

Increase the demand for air travel through reaching more customers and increasing the frequency of travel per customer: There is already a growing percentage of Americans is using air travel. In 1991, 76% of American Adults reported that they had flown at some time in their lives and 32% had flown in the past year. The increase in American air travel can be seen in the table below:

Percentage of American adults who have:

1981

1989

1990

1991

…ever flown?

65%

78%

74%

76%

…flown in the last 12 months

24%

34%

31%

32%

The table implies that American’s are increasingly adapting to air travel and this means that their is an opportunity for American Airline’s to continue their expansion.

Price discrimination models: Price discrimination models provide an opportunity for American Airlines to capture the two main customer segments, business and pleasure travelers in the most profitable way. Using price discrimination models provides an increasing opportunity.

Percent of American Adults traveling on:

1989

1990

1999

2001

Business

52

51

42

41

Pleasure

47

49

53

57

This provides an opportunity for American Airlines because the two segments have different demand fluctuations and buying characteristics and if American Airlines can capture both markets through different pricing fares then it will increase their yield per customer, smooth out overall demand

fluctuations and achieve profit maximization. The differences can be distinguished by demand and buying values.

Buying differences: Business travelers are more loyal to one particular airline because they have the ability to build up frequent flier miles. They are less pricing sensitive due to being more time sensitive. On the other hand, leisure travelers are less loyal, more price sensitive and more flexible in terms of time, date etc.

Online Reservations: Like low cost airlines and adopt online reservations, which mean less need for travel agents, no paper tickets and convenient booking.

American Airlines currently only serves 80 destinations worldwide, compared to 182 locations in the U. S. mainland and Hawaii. Therefore, there is a strong opportunity to focus on increasing long haul, international flights as opposed to short haul flights.

Threats:

After the deregulation of the airline, industry competition intensified as national and regional airlines grew or merged and became fixated on profit maximization. American Airlines major domestic competitors are United Airlines and Delta Airlines as they both operate with similar scope and service to American. American Airlines main competition from regional airlines includes US Air, America West, Southwest, TWA, Northwest and Continental. US Air serves primarily eastern and southwestern markets. American West and Southwest are discount carriers serving the Southwest

and California areas. TWA that offered primarily coast-to-coast service, Northwest that served the Northern tier of the U. S. and Continental that served the southern tier. Furthermore, mergers meant that the combined market share of the four largest airlines rose from 54. 2% in 1982 to 64. 8% in 1987.

Growth of low cost airlines: Low cost airlines are expanding rapidly. Southwest in particular is successfully promoting its bargain fares, low cost and no-frills approach to service and are the seventh largest U. S. carrier, though only operating in 15 states for local, and short haul markets. The low cost airlines are able to charge extremely low discount prices because:

Distribution costs are reduced using direct selling through the internet or call centers and having no tickets

Pricing segmentation only occurs on two variables: the date of booking and the effective demand of that specific flight so there are less complex fares and less restrictions imposed to increase customer satisfaction

The operating expenditure passenger and their operating margin are also significantly higher. American Airlines does not have the ability to compete directly through matching such low prices because they could never achieve such low costs, nor does the brand image of American Airlines compliment this strategy.

Airline Industry is vulnerable to price wars: Industries that have extra capacity, high fixed costs, and low differentiation and are price elastic are the most vulnerable to price wars.

High Fixed costs and extra capacity are profit-damaging combinations because it means that airlines must have high yields through yield management in order to maintain profitability, which is very complex.

Low Differentiation means customers see airline travel as a commodity- like business. In general, they simply want to get from one city to another in the shortest amount of time, at a convenient time that fits their schedule, and at a reasonable price.

High Price Elasticity: Due to the combination of the above, airline travel is typically price elastic. Therefore, airline companies are becoming more inclined to lower prices in order to stimulate demand.

Sensitive to economic downturns due to high fixed costs structure, for example in 1991 the industry's cumulative losses were $2. 67 billion

The dominant distribution channel is the travel agent. Therefore, the cooperation of travel agents with the Airline is necessary. Airlines get the agents cooperation through giving them commissions from ticket sales.

Key Issues

Develop a pricing strategy that will increase the demand of air travel and the long term profitability of the airline industry.

Identify and evaluate alternatives by considering competitors reactions, customer impact on yield, costs and long term profitability.

1. Value Pricing

The main objective of this pricing strategy was to provide ‘ simplicity, equity, and value’ for air travel, compared to the existing system with a multitude of ever changing fares and discounts.

Value Pricing:

Segmented Pricing: On any given flight, there would be only four different fares: First Class, Regular Coach, Discount Coach (booked seven days in advance) and Discount Coach (booked twenty-one days in advance). Each fare had different restrictions and offerings. E. g., Discount coach involved Saturday night stay over, advanced purchases (21 days), not refundable but they could be re-issued for another flight and priced 49% below the regular coach fares.

New fares will be 38% below the levels of comparable existing fares and will be the same for everyone, meaning no need for special deals.

Advertising: American Airlines would spend $20 million on media time and space over two weeks. They anticipated that revenue would increase additionally by $300-350 million annually and cost savings of $25 million per year.

Pros

· Business travelers will benefit from ‘ value pricing’. The advantages for business travelers is that, they no longer need to worry about inflexible restrictions attached to reduced fares, forcing them to pay higher prices. Now they can get the advantage of being able to book at short notice but

ensuring that they will still receive the same 38% off full Coach with no restrictions with any time fares. Furthermore, if they can book in advance they can pay even less.

Reduced Costs: American Airlines forecasts cost savings of $25 million per year through the reduction in the number of fares offered, as it will reduce its CRS from 500, 000 to only 70, 000. Secondly, as all flights will be priced based on the distance of the flight path, so the variable costs actually determine the prices, in theory providing higher revenue.

Cons

Price elasticity: Air travel has quite high price elasticity as a review found that the majority of estimates were between the range of -. 8 and -. 2, with the elasticity for business travel generally being less than unity, while that for pleasure travel typically exceeding unity. Therefore, leisure travel demand changes with changes in price more than business travel because of a price change.

American Airlines, the price sensitive customers will be highly dissatisfied by the new ‘ value pricing’ and they will be encouraged to switch to low cost airlines.

American Airlines will no longer benefit from the business travelers that were typically price insensitive but time sensitive and so prepared to pay the higher costs. This will have incremental affects on yield and profitability as the high fixed costs of airlines previously depended upon business travelers to buy higher priced tickets.

Competitors Reactions: For air travel demand, which in turn creates the lack of customer brand loyalty to airlines, a 38% reduction in American Airline prices in theory would cause customers to switch to American Airlines. However, American Airlines has failed to consider competitors reactions in their ‘ value pricing’.

Lower their prices to match American Airline prices to guarantee the consumer the lowest fare without committing to a lower price but ultimately keeping their customers and sending the message to American Airlines that they should increase their prices.

In turn, this will reduce the profitability of the Airline industry, as airlines will need to keep lowering prices in order to remain competitive, leading to a decrease in profit margins and economic growth.

Competitor’s reactions will ultimately prevent American Airlines from reaching their forecasted revenue for 1992.

Promotion problems: The travel agents are less likely to promote this reduced fare platform and the CEO only plans a one-time $20 million advertising effort.

High Fixed Costs of Airlines: American Airlines has a high cost structure and as a result, they rely on high-yield and high traffic. Therefore, it is not feasible and it will be disastrous for them to lower costs in the long term without reducing their fixed costs.

They expect market share to increase by an additional one-half of 1% of the total U. S. market.

They believe that in the second quarter of 1992, revenues could decrease by $100 million, but that revenues will increase by $300-£350 million for the entire year.

They assume that the demand for air travel as a method of transportation will increase by 3-4% with the new pricing structure.

American Airline's yield and revenue assumptions are flawed because the value pricing is assuming that all present factors in the industry will remain the same but in reality competitors will match prices and travel agents will not be so cooperative.

Break Even changes: American Airlines would need to increase their sales dramatically in order to break even, which will be very difficult.

Regular Coach

1990

1992

1992

Route: New York- Chicago

Old

New

New (including $20m advertising)

Selling Price

$854

$500

$500

Total Revenue (assume sell 1000)

$854000

$500000

500000%

Variable Cost as a percentage of the total costs

3. 60%

3. 60%

3. 60%

Variable Costs per person

$40

$40

$40

Total Variable Costs

$40000

$40000

$40000

Unit Contribution= selling price- variable cost

$814

$460

$460

Fixed Costs as a percentage of the total costs

96. 40%

96. 40%

96. 4% + £20m

Fixed Costs (96. 4/3. 6= 26. 777×40000= 1071111. 111)

1071111. 111

1071111. 111

21071111. 11

Break Even= fixed cost/ unit contribution

1315. 861316

$2328. 502415

45806. 76328

Break Even sales change

1012. 641099

44490. 90196

Break Even Point % sales change

176%

3481%

Pros

Product Differentiation will be valued: On long haul flights added ‘ frills’ are valued because passengers are on the plane for longer so they will require more services in order to feel comfortable. There are a range of services and products that American Airlines has the opportunity to offer customers to differentiate their fare prices..

Reduce the risk of a price war.

Through concentrating on long haul flights and maintaining low but profitable prices, competitors will be less likely to reduce their costs because American Airlines is the market leader and every competitor wants to have profit maximization. Furthermore, it will increase the long-term profitability of the industry as demand and profitability will increase.

Increase customer brand loyalty: American Airlines are differentiating their products from competitors and if these differences are valued then customers will be encouraged to be loyal to American Airlines, as they will receive the extra benefits from the products on top of their frequent flier program.

Opportunity gap in the market: Expanding into new markets will increase their customer base and market share as long haul flights e. g. 15-18 hour will become more and more popular through increasing international business communications.

It is impossible for American Airlines to match the leading low cost airline fares while at the same time operating at a profit due to their higher cost per seat mile.

The current brand is image of a high quality service airline.

Simplifies pricing without the need to price too low and curbs demand, so customers will be willing to pay more and also they will better maximize flight capacity through curbing demand and so they will not suffer from opportunity costs found in ‘ value pricing’.

Cons

Increasing the number of services will increase their variable costs per customer. Fixed costs will rise dramatically from initial expansion.

Risk of International Business Problems:

As American Airlines expand they must ensure that they maintain good communication or else their costs could increase

Foreign markets will bring more challenges when facing new competitors

Currency differences

American Airlines does not react to the growing number of low cost airlines by matching their low prices then they will expand further, increase their market share within America with price sensitive customers and decrease American Airlines competitive advantage. This could reduce the profitability of the U. S. air travel industry in the long term.

Require heavy investment, funding, planning and advertising in order to implement and communicate the difference of services between flight fares to customers and get customers to value these differences.

Recommendation:

Recommended that ‘ Value Pricing’ be adjusted and combined with alternative three, to focus on long haul flights and segmented pricing through service differentiation as despite ‘ Value Pricing’ being a very innovative pricing strategy it has many shortcomings. The ‘ value pricing’ must be embedded in a broader and consistent marketing strategy.

The ‘ value pricing’ aim to simplify fares through offering four fare structures should be implemented as this will reduce CRS costs and increase customer understanding of fare prices. However, the restrictions imposed should be reduced on the discount fares, otherwise customers will go to low cost

airlines. Instead, it is recommended that fences be built between the different fares to prevent customers from switching from higher fares to discount fares through service differentiation, not just the transportation and a few marginal restrictions. Furthermore, American Airlines should focus on long haul flights as opposed to short-medium haul flights within America because it is within these flights that service differentiation is highly valued. In addition, if American Airlines can expand into more markets it will increase their market share and long-term profitability. This will also prevent the erosion of profitability in the airline industry because it will prevent a price war.