# Porter's five forces – the airline industry essay

Environment, Air

In this paper I will be analyzing the airline industry using Porter’s Five Forces. Porter’s Five Forces is a business management tool that allows firms to possess a clearer perception of the forces that shape the competitive environment of an industry, and to better understand what these forces indicate about profitability with regard to the microenvironment. The forces include Competitors, Threat of Entry, Substitutes, Suppliers, and Customers.

When firms are able to widen their conception of competition beyond their direct competitors, and consider the broader economic fundamentals of their industry, they are able to form better strategy to better optimize their profitability. The airline industry is one characterized by low profitability, yet individual airlines are able to gain profits above the industry average through the consideration of Porter’s Five Forces. Competitors The most obvious force that impacts firms within the airline industry is the threat posed by rival airlines.

The airline industry is characterized by a relatively high amount of rival firms, which creates an intense degree of rivalry between airlines. This rivalry is exacerbated by the microenvironment the airline industry finds itself in where competition is based almost entirely on price. This is due to the fact that all airlines offer essentially the same service to their customers and also by the fact that customers purchase flight tickets online. Customers that purchase tickets online are able to directly compare the prices of similar flights and will almost always purchase the cheapest available tickets.

This causes airlines to have a limited capacity to differentiate themselves from rivals. All of these factors drives down the price of airline tickets and hinder profitability of airlines. An industry has a higher potential for profitability when firms vary in size. The manifestation of this desirable industry condition would dictate that there are large international firms as well as strong regional competitors. While there are many dominant large airlines, many smaller airlines have changed the fundamentals of the industry and gained market share through the establishment of regional iches.

An example of this is JetBlue Airways, a low cost airline that began a focus city operation in 2001. JetBlue serves specific regions of the United States and has been able to marginally compete with large airlines with minimal overhead. While JetBlue experienced net losses from 2005-2007, Jet Blue has been able to overcome challenging industry conditions, relating to a high degree of rivalry, through the application of smart strategy. Threat of Entry Threat of Entry is another component of competition that has substantial influence over the profitability of an industry.

Optimal industry conditions include the presence of many barriers to entry, ensuring that new competitors will have difficulty taking market share from existing firms. There are few barriers to entry within the airline industry; in part caused by the ability of new airlines to rent aircraft rather than purchasing. This allows them to provide the same service as established airlines with diminished overhead, allowing them to reap greater returns on investment, and ipso facto higher profitability. These conditions give new airlines a competitive advantage over one's that have purchased aircraft.

This effectively demonstrates how far-sighted firms that use considerations of the microeconomic landscape to influence their business model are able to circumvent some of the unfavorable circumstances of an industry to achieve above average profitability. An additional microeconomic force that should be considered is the appeal of the airline industry held by those who perceive it to be a sexy area of business and seek to enter into it for this sole purpose. This perceived appeal also imposes an increase in competition for existing airlines.

Firms that enter into an industry following an arbitrary inclination and struggle initially to gain returns on investments, the original appeal becomes a non-factor in the forming of strategy. This provides further proof of the importance of making consideration of the components of the competitive environment and their effect on profitability. Substitutes Substitutes to air travel pose a significant threat to the profits of the entire airline industry. It is advantageous to be in an industry with few or no substitutes as they diminish profitability for the industry as a whole.

There are many alternative ways in which a person can travel long distances. Therefore, the airline industry is threatened by many substitutes. Trains are the primary substitute to air travel in that they provide long distance travel at marginally lower expense to the buyer. Train stations are also generally more accessible to the public than an airport, which adds further appeal to the substitute of traveling by rail. An advantage held by airlines is the fact that air travel is widely known to be a much faster mode of transportation, yet more and more buyers are choosing train travel over air travel strictly slight for the price advantage.

Another substitute mode of transportation that poses a threat to the airline industry is the use of automobiles. Price differential is a factor in why people choose driving over booking a flight. While flying saves a great deal of time over driving, it can be considerably cheaper to drive a long distance, depending on the type of car and the distance traveled. Availability is a supporting characteristic of automobiles as a substitute to air travel. The fact that roughly 57% of Americans drive motor vehicles demonstrates the potential threat that the alternative of driving poses to the profitability of airlines.

Suppliers Suppliers of goods within an industry have an impact on the profitability of firms that use those goods, because they are fighting over a share of the same potential profits. Firms that supply goods such as aircrafts, aircraft engines, and aircraft gates to airlines pose a significant threat to the profitability of airlines, in that they have considerable bargaining power and channel a great deal of profits from the services that airlines provide.

Firms that supply these goods such as Boeing, Airbus, GE, and Rolls Royce consistently receive higher profits than any major airline. Suppliers of labor to an industry also have the capacity to pose a threat to the profits of firms in that industry. In the airline industry, where labor is unionized, employees have a great deal of bargaining power. This condition dictates that airline personnel such as baggage handlers, flight attendants, flight dispatchers, ticket agents, avionics technicians, in-flight security personnel, and particularly pilots have the ability to ompletely shut down operations over any dissatisfaction with management or wages.

The potency of the labor suppliers’ bargaining power over airline industry bears an insoluble hindrance to the profitability of firms, contributing to its unattractiveness as an industry. Customers The airline industry is characterized by strong bargaining power of its customers. Airlines face difficulty in attempts to differentiate its services from those of other firms. Buyers are therefore extremely price sensitive, causing them to develop fickle buying habits.

This characteristic is effectively demonstrated when a buyer is purchasing flight tickets online; The most common means of airline ticket purchase, where customers have access to the ticket prices of multiple airlines. The customer will choose who he flies with entirely based on the price, as there is no significant difference between the services offered by one airline to the next. This circumstance provides the customer with significant influence over the price of flights, which results in diminished profitability within the industry.