Airline competition

[Transportation](#), [Airlines](#)

Analyze the economics of increased competition for established airlines from low cost operatorsBefore the airline industry was deregulated, major carrier's behavior was significantly influenced by CAB regulatory policies. Morrison & Winston (1986) says that although regulation limited the flexibility of fares and the entry into markets, flight frequency was explicitly not regulated. This means that airlines engaged in intensive non price competition through service frequency as well as in-flight amenities. Morrison & Winston (1986) says that since 1982 entry for many airlines has been granted by statute to all carriers that are fit, willing and able. After the passage of the deregulatory legislation, the board allowed for fare movement in a zone constrained only for certain increases above pre-deregulation levels. Morrison & Winston (1986) continues to say that it was therefore expected that with deregulation, travelers would incur a loss from reductions in flight frequency, but that the loss would be more than offset by lower fares, especially for coach travelers. Through the elimination of entry restrictions, deregulation gave carrier increased freedom and flexibility to restructure their network into effective hub and spoke systems. According to Morrison & Winston (1986) in the competitive environment encouraged by deregulation, the development of a hub and spoke route system adopted by low cost airlines as a marketing tool. Dewine (1998) says that deregulation allowed entry by existing airlines into new routes and also allowed the entry of new low-cost, low-fare airlines into the industry. He thus says that competition by new entrants began rising immediately after deregulation until it reached in peak in 1985. Price dispersionAccording to Borenstein & Rose (1986) one of the most important factors that have affected US airlines is price dispersion. This is because airline charges to different passengers on the same route are different. They thus said that there is substantial dispersion in the prices that an airline charges different customers in the same market. Borenstein & Rose (1986) says that differences in average fares across carriers on a route are small relative to differences in price across customers for each airline. The sources of this price dispersion result from variation in the cost of serving different passengers and discriminatory pricing. The market structure has significantly played a major role in price dispersion. Borenstein & Rose (1986) indicated that price dispersion should increase with concentration if industry elasticity's which are prevalent on the basis of segmentation and decrease with concentration if heterogeneities in cross elasticity. Besides this population attributes as indicated by Borenstein & Rose (1986) have increased either the variance of attributes in the population that reflect buyer's industry elasticity. Greater population density in established carriers is likely to generate balance product variety as measured by flight frequency which may affect both monopoly type and competitive type of discrimination found in low cost airlines (Borenstein & Rose, 1986). Price dispersion in most cases depends on firm's relative position in the market. Borenstein & Rose (1986) pointed out that a firm with a large share of the flights on a route may be less responsive to differences in cross-elasticity when setting its prices. In this context if a low cost airline offering 10 of the 11 daily flights on a route, then a customer may not be willing to switch from his most preferred departure time hence this may have little impact on the carriers pricing strategy.

Cole (2005) says that the challenge of low cost air lines and economic downturn with over 35% of business travelers using low cost operators is based on low fares which are attributed to price elasticity but also better than expected amenities that is service elasticity. One the major competitive areas include the provision of wider seats or additional space and other services which presents a major challenge to conventional airlines. Cole (2005) therefore indicated that " for many of the full service carriers such as American, Cathy Pacific and BA, a new generation of in flight products was necessary but which achieved a higher service level without adding costs" (p. 81). According to Kanafani & Kuroda (2005) airlines transportation networks exhibit what are termed as network economies which means that the companies spatially confers either or both demand and supply benefits. Subsequent entrants who were using low cost business model have been a major challenge to the airline industry around the globe. Kanafani & Kuroda (2005) continues to say that the industry has come under stress due to the dot-com implosion and the general world economic downturn. At the same time it has been noted that low cost airline carriers have moved to more connectivity as they mature increasing the competition in the airline industry (Kanafani & Kuroda, 2005). Studies show that emerging from deregulation airline strategies, including their network configurations was driven by both demand and supply side forces. Kanafani & Kuroda (2005) in this context says that on the demand side, large firms are being favored because of their capability to serve a large geographic coverage while having greater value on loyalty programs. Low cost carriers tend to exhibit common product and process design characteristics that enable them to operate at much lower cost per unit of output. Kanafani & Kuroda (2005) continues to indicate that many low cost start-up airlines have extended the look and feel of their aircraft. Unlike the established airlines, Kanafani & Kuroda (2005) says that the advantages of low cost airlines start from the fact that the purchasing power is one with the obvious exception of the aircraft itself, low maintenance, parts, supplies, even safety cards are purchased in one model for the entire fleet. Besides the above merits they also enjoy reduced training costs, with only one type of fleet, employees do not only focus on one aircraft but also become specialists. Kanafani & Kuroda (2005) also indicates that economies of density can be achieved in training. In low cost airlines there is no expensive retraining of employees when they reach a certain seniority level or need to work at a different base hence further savings are achieved through higher productivity and through specialization in all departments of the airline (Kanafani & Kuroda, 2005). Established airlines are obliged to choose the type of airports to use. Low cost airlines achieve economies of increased competition because they focus on secondary airports that have excess capacity and are willing to forego some airside revenues in exchange for non-airside revenues that are developed as a result of the traffic stimulated from low cost airlines (Kanafani & Kuroda, 2005). In other terms for low cost airlines secondary airports charge less for landing and terminal fees and make up the difference with commercial activity created by the additional passengers. In addition, Kanafani & Kuroda (2005) says that secondary airports are less congested allowing for faster turn times and more efficient use of staff and the aircraft.

Vasigh et al., (2008) established that economic liberalization is a major factor affecting established airlines. This implies that government restrictions on an economy such as wage and price controls or excessive regulation constrain demand. Vasigh et al., (2008) thus say that " when such artificial barriers are lifted the market place dictates demand for goods and services and therefore increased air travel is always the result" (p. 19). With government regulation, in place it implies that low cost airlines are favored and are granted access with some sort of a fare structure that is structured to cover average costs. This increases competition and leads to increased air traffic. This does not in any way favor established airlines because of the freedom of low cost airlines to fly to whatever destination they wish (Vasigh et al., 2008). The economic impact of increased competition from low cost airlines can be divided into three categories which include direct, indirect and induced. Vasigh et al., (2008) says that direct economic impact represents economic activities that would not have occurred in the absence of low cost airlines. He continues to say that in the air line industry, both low cost and established airlines provide the economy and local communities with a direct economic impact which include salaries of airline personnel, fuel purchased, landing fees and other expenditures. Kanafani & Kuroda (2005) says that analytically it is important to note that all the above reductions in cost allow low-cost airline carriers to offer very low fares. Also they that the focus on short haul, point to point markets not only achieves lower costs but has revenue advantages as well. Kanafani & Kuroda (2005) established that further differences from full service carriers, including one way pricing, limited fare classes, no refunds without a penalty and fewer fences contributes to the simplification of revenue management. It has been noted that unlike long haul carriers (established airlines) low cost airlines are well designed to maximize this metric. The possibility of mergers between established airlines as a strategic response to this type of competitionAirline mergers have delivered good results although it takes a long period to establish a sustainable merge. Lee (2006) says that mergers have become a response to circumvent foreign ownership and entry limitations, allowing airlines to have large airport presence at both ends of a market. Through the formation of mergers established airlines are capable of gaining market presence at both ends of the market. Lee (2006) also says that the strategic interaction between firms shows a larger competitive effect of airlines with greater presence on smaller airlines. Mergers between incumbent airlines have direct effect can be offset by an increase in the profitability of rival firms. There is a greater possibility of mergers between established airlines because this type of alliance comes with some tangible benefits such revenue enhancement and cost reduction (Iatrou & Oretti, 2007). Mergers take advantage of the expertise of each airline in its respective market to meet customer requirements in terms of schedule, comfort and service. Iatrou & Oretti (2007) continues to say that when airlines merge they counter competition from other low cost airlines because each partner inside knowledge helps the alliance to make the best choices and the best predictions for the future. The proposed merger between continental airlines and United Airlines will be a strategic response to low cost airlines because when they merge each airline can focus specifically on the particular segment whether technical or operational in which it has a competitive advantage (Iatrou & Oretti, 2007). In addition Iatrou & Oretti (2007) indicated that " through merger established airlines can create large databases through which to learn and besides this share knowledge about different subjects such as IT, technology, organization activity and demographic information" (p. 134). With these store information mergers has the possibility to determine more accurately the competitive environment, the quantity, quality and price of the air transport product produced and the price that meets the current demands of the passengers, benchmarking against competitors and reducing market uncertainty (Iatrou & Oretti, 2007). Compared to low cost airlines when established airlines merge it helps them to open up opportunities to create bridges between airlines at different levels. Iatrou & Oretti (2007) says that " at the operational level merging brings detailed knowledge at hand and where specialists can communicate with one another" (p. 135). One of the cost benefits that partners in a merge gain is that they enjoy combined bargaining power in purchases from key suppliers. We should realize that when global airline mergers first began to take shape in the 1990s and since then they have promised a wealth of opportunity in terms of enhanced revenues and cost reduction. The ongoing merger between Delta Air Lines with Northwest airlines has helped Delta Air Lines which kept its name to become the world's largest carrier by passenger traffic. In their further studies Iatrou & Oretti (2002) noted that deeper analysis shows that airline alliances have delivered promising results. At the same time all air transport industry experts agree that mergers have not yet reached their full potential because their members have been reluctant to purse integration (Iatrou &

Oretti, 2007). The possibility of future alliances is there as competition increases although it has been noted that fear still exists among small and medium airlines that entering into mergers with large carriers like British Airways and Lufthansa would implies losing control over matters such as route development, pricing, branding, customer service among others. Iatrou & Oretti (2007) further says that according to Air France and KLM executives, this merger has created the truly European carrier for the European market. They also indicated that with its focus on long haul routes, mergers will spur further growth on short haul flights of well known discount carriers such as Ryan air and easy Jet. In conclusion the analysis of the increased competition between established airlines and low cost carries was done in the domain of price dispersion, networked economies and liberalized economies. Price dispersion focuses on the pricing strategy used by established airlines which initially monopolized the carrier market and the threat presented by emerging airline industries. Low cost airlines focuses on reducing the ticketing price and increasing the frequency of flights a situation which is seen a major threat to established carriers. On the other hand network economies means that the airline firms spatially confer with either or both demand and supply benefits. Subsequent entrants who were using low cost business model have been a major challenge to the airline industry around the globe. To counter this increased competition, it has been noted that t mergers between established airlines and middle level carriers or between low cost carriers have turn out to be a comeback to outwit foreign ownership and entry limitations. This has allowed airlines to have large airport presence at both ends of a market hence increasing their market share. At the same time merger between low-cost airlines carriers helps them to open up opportunities to create connections between airlines at different ranks.