

Airline Industry - Increasing Competition and Alliances

American and European Airlines

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Why airline industry is interesting?

- Flying is on the rise
- Airlines in the US:
 - 620 million passengers
 - Employ directly 1 million workers
 - Pay \$18 billion in taxes
 - Essential social, leisure and business link
 - Aircraft maker Boeing is the biggest American exporter

Old Era of Regulation

- Heavily restricted entry by regulators
- Airfares subject to approval by regulators
- Approval needed also for new routes
- Regulatory capture inevitable
- In 70s unregulated intrastate airfares in CA were 40% cheaper than airfares in comparable but regulated Eastern interstate routes

Industry Deregulation

- Deregulation of US market in 1978

“I have more faith in greed than in regulation”

Alfred Kahn, Civil Aeronautics Board, 1980

- Free entry subject to safety rules

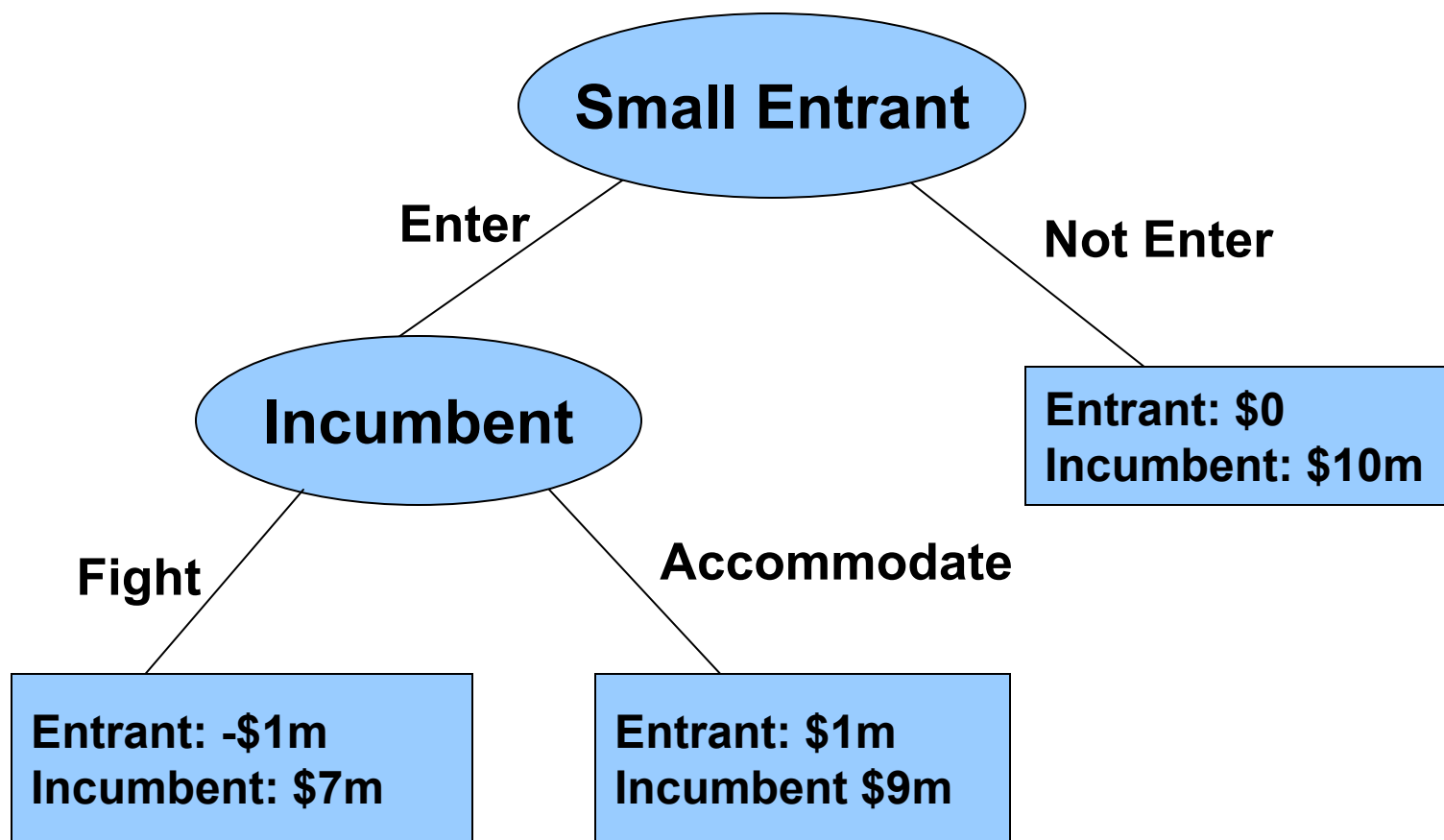
Survival of the Fittest?

- More than 60 new interstate carriers by 1983, i.e. New York Air, Republic, Piedmont, Ozark Airlines, SouthWest
- Most of them went bankrupt, was acquired or merged with the incumbents
- Airfares went down by 20% in the 80s, rising late in the decade however.

Rules of the Game

- The entrant
 - moves first
 - decides to Enter or Not Enter a single route
- The incumbent:
 - operates many routes
 - observes entrant's choice
 - moves second
 - decides to Accommodate or Fight entrant

Playing the Game



Top Dog and Puppy Dogs

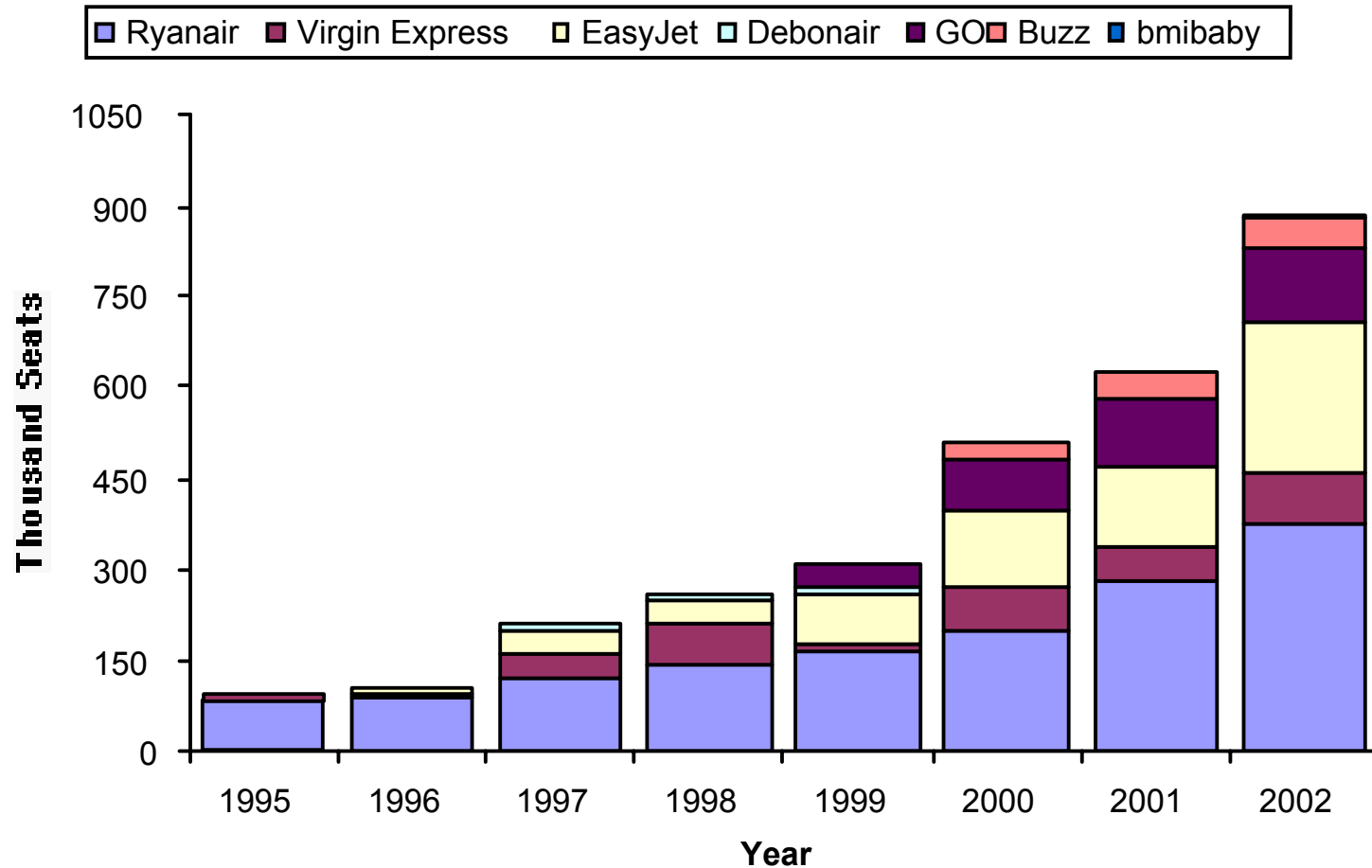
- The incumbent accommodates entry of any single small entrant – “Puppy Dog”
- Then it will face entry by many Puppy Dogs in its other routes
- To prevent this the incumbent should turn Top Dog:
 - Fight any Puppy Dog
 - Message: “Don’t mess up with us”

What happened in Europe?

- In the past markets dominated by national carriers, often state owned and subsidized by governments
- Compare two routes in mid 90s:
 - Washington-New York: 216 miles
 - London-Paris: 211 miles
 - European airfare 30% more expensive
- European airlines deregulation in 1997

Survival of the Fittest: Episode 2

Flood of new entrants in Europe



Easy Jet – LEAN and HUNGRY



Easy Jet – LEAN and HUNGRY

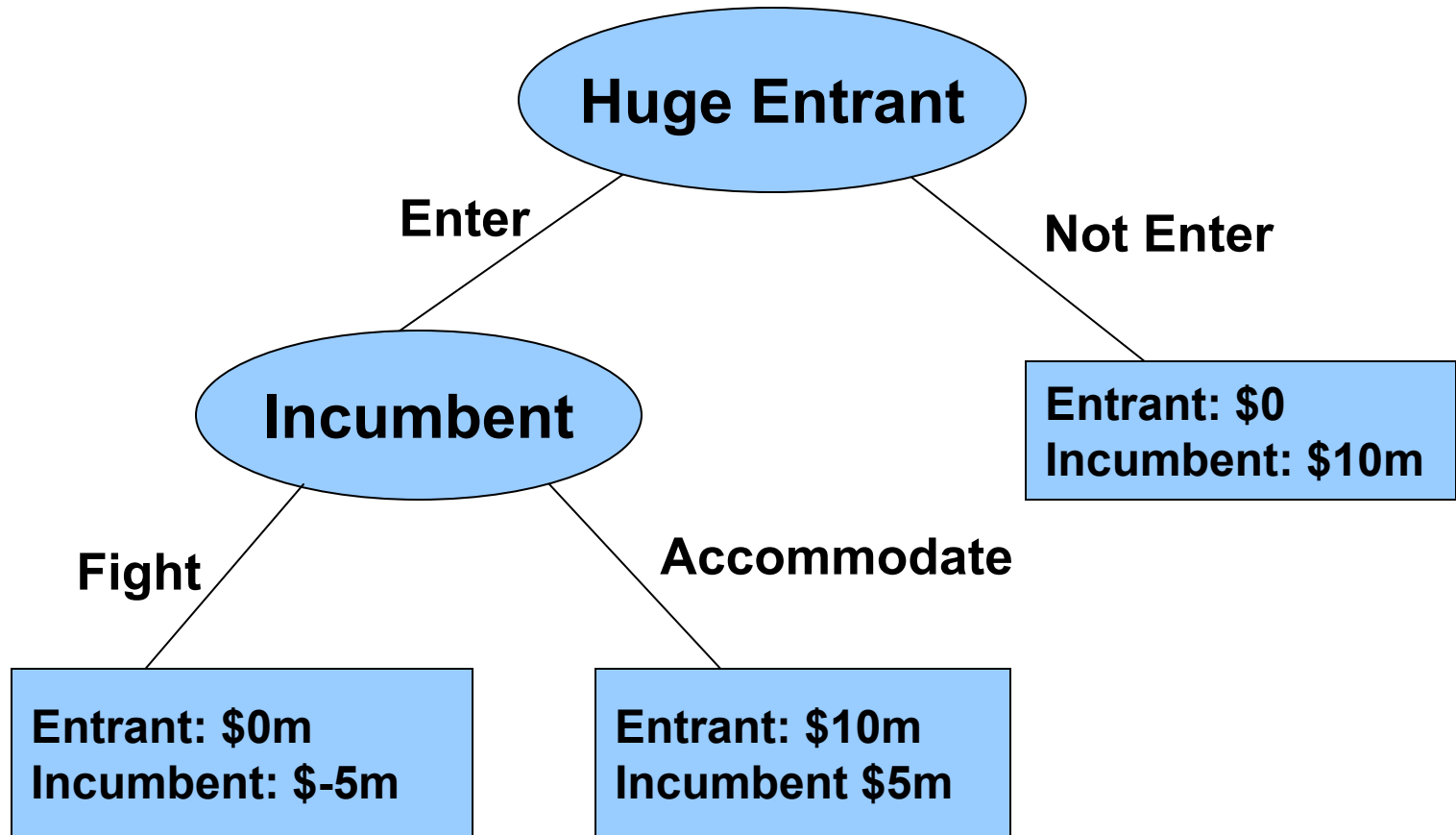
- **Easy Jet is LEAN!!!**

- No thrills, only web tickets
- Two types of plane
- Plane is to fly not stay in the hangar
- Plane not full? Sell ticket for 10 Euro

- **Easy Jet is HUNGRY!!!**

- 2002: Firm order of 120 Airbus A319 aircraft in 5 years with option for 120 in next 5 years

Losing the Game? Change the rules



Top Dogs turned Fat Cats

- Big incumbents were made “Fat Cats with health problems”
- Subsidies in EU: “One time, last time”
- Easy Jet and Ryanair earn profits consistently
- SwissAir, Sabena went bankrupt
- Read news for more airlines obituaries

Summary: Cheaper airfares on the way

- Entering? Better be Lean and Hungry
- After September 11 incumbents incurred huge losses and became vulnerable
- New wave of entrants: JetBlue, Wizzair
- Weakened incumbents don't fight back
- They streamline operations, go abroad, form alliances and also call for subsidies
- US-EU talks on trans-Atlantic "Open Sky"