

THE EVOLUTION OF THE LOW-COST AIRLINES IN US. THE CASE STUDY ON SOUTHWEST AND JETBLUE AIRLINES

Teaching Assistant PhD. Laura DIACONU (MAXIM)

Faculty of Economics and Business Administration, Al. I. Cuza University of Iasi, Romania

dlaura_es@yahoo.com

Associate Professor PhD. Cristian C. POPESCU

Faculty of Economics and Business Administration, Al. I. Cuza University of Iasi, Romania

popescu@uaic.ro

Abstract:

The low-cost companies emerged for the first time in the USA airlines' industry, their model being subsequently taken by the world-wide operators. The purpose of the present paper is to analyze the development stages of the USA low-cost operators' market, identifying the determinants of the evolution of two major airlines: Southwest and JetBlue, through an empirical study conducted on these two companies in the end of the year 2009. Therefore, the information was collected both from secondary and primary sources, fact that allowed not only a descriptive approach of the low-cost airlines, but also an empirical research based on a questionnaire delivered by email to the two US operators. The information received was analyzed, tabulated and interpreted for each operator. The conclusions of this study suggest the fact that the market of the low-cost airlines from USA is in a stage much more advanced than those from other regions, being nowadays in the maturity phase. Regarding Southwest and JetBlue, we do notice the fact that the methods used by them in lowering the tariffs are based not only on the cost reduction, as it is the case of other low-cost operators, but also on maintaining a good ratio between their price and the quality of the services offered. The results presented in the end of the paper made the object of a larger case study.

Keywords: low-cost airlines, cutting costs strategy, competition, traditional operators, development stage

JEL Classification: F23

INTRODUCTION

Firstly developed in the US airlines' industry by Pacific Southwest, the concept of low-cost firm was subsequently implemented not only by the operators from Europe, Asia and Australia but also by firms that were acting on these markets in other fields of activity. Actually, the presence of the low-cost companies revolutionized the airline industry. The new competitive price structure established by these firms had a strong impact on the traditional companies, which have lost large parts of their profits. The responses to the challenges addressed by the low-cost operators came more rapidly from the traditional European and Asian airlines than from the USA companies, which, actually, were the first ones that had to confront with this phenomenon. Being forced by the competitive pressure exercised by the low-cost airlines, the traditional operators have lowered the prices. Yet, these reductions were not substantial because the traditional companies could not make the necessary adjustments in the level of the administrative, operational and human capital costs.

The main purpose of this study consists in analyzing the development stages of the USA low-cost operators' market, identifying the determinants of the evolution of two major airlines: Southwest and JetBlue. In order to reach this objective, it was conducted an empirical study on the two low-cost airlines (Southwest and JetBlue), which were selected according to the experience and performances achieved up to now. The contact with operators was established through the email, asking their cooperation in order to be included in the study. Subsequently, we delivered to each company a questionnaire, through email, that included general questions regarding the main methods used in developing the price strategy, the difficulties that they had to face, during years, in implementing it and also the critical factors on which relied the success of the firms. The information received from the Customer Relations Departments of the two companies was analyzed, tabulated and interpreted for each operator, being briefly presented in the last part of this paper.

THE EVOLUTION OF THE LOW-COST AIRLINES IN THE USA MARKET

A low-cost airline is that operator which offers low tariffs, mainly because it eliminates many traditional services. Usually, the methods used by the low-cost airlines to cut the costs consist in maximum usage of the aircrafts, selling tickets through the internet (avoiding in this way the services paid to the travel agencies), the open seating system, only one type of tickets corresponding to one class (fact that allows the existence of a greater number of seats per aircraft than in the case of the traditional companies), the usage of the secondary airports, often located near the small towns, minimum staff on board, quick turnarounds and short breaks between two flights, flights on short distances, only point-to-point (without connections to other destinations), the paid catering services etc. (Doganis, 2001).

As we mentioned before, the "revolution" generated by the low-cost airlines started in USA, the concept being developed by Pacific Southwest but implemented for the first time by Southwest Airlines, in 1971. Subsequently, the low-cost airlines sector has gradually developed, in 2003 these companies having almost 25% from the internal market of the US, considering the number of the transported passengers. Although the rest of 75% belonged to the traditional operators, various studies show the fact that three quarters from the passengers transported by these companies were not satisfied with the ratio price paid - quality received. "The Americans were attracted by the low-cost companies because of their efficient services, with relatively high quality standards and with very reasonable prices. Operators such as Southwest or JetBlue became not only central pillars of the US airlines, but also the models of the best implemented practices, worthy to be followed by the other traditional companies" (*Successful Meetings*, 2005, pp. 47-64).

The US airline industry had experienced a certain timeframe that can resemble a life cycle of events that include the introduction up until the maturity of the low-cost market (Diaconu, 2009). This life cycle can be compared to similar situations that other low-cost airlines are, nowadays, experiencing around the world. Although the growth of these operators does not follow a uniform life cycle in all cases, a number of stages in the growth of low-cost carriers are clearly evident. Figure 1 shows the life cycle of the development of low-cost operators in the USA compared to the market developments of the low-cost airlines around the world.

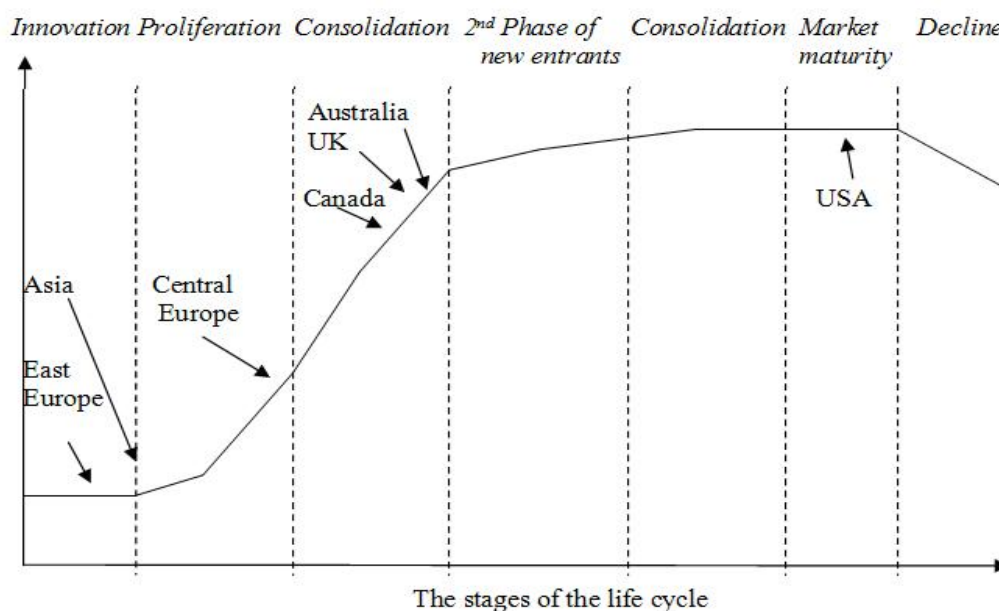


Figure 1. Market Developments of the USA Low-Cost Airlines compared to those from the global level¹

¹ Note: This life cycle model was developed considering the information regarding the low-cost companies from various specialized articles or reports of the airline industry

We have to mention that this entire model of the life cycle is specific for the US airline market. The state and the continents that are shown in the Figure 1 suggest that, nowadays, the low-cost operators from these markets are in that particular stage of the life cycle. So, we can notice that, while market of the low-cost carriers from Canada, United Kingdom and Australia has reached the consolidation phase, in Asia and Eastern Europe this market is only at the beginning, in the innovation stage, and in the Central Europe in the proliferation one.

As it can be seen in the Figure 1, in USA, the market of the low-cost carrier has already followed five stages up to it's nowadays maturity stage: the innovation, the proliferation, the consolidation, the second phase of the new entrants and the second phase of consolidation (Francis, Humphreys, Ison and Aicken, 2006).

The innovation stage (1971-1978) was possible due to the fact that at the beginnings of the '70s the regulations existent in USA allowed the development of the low-cost airlines but, until 1978, when the US Deregulation Act was adopted, these operators could not set routes, frequencies and fares.

The proliferation period of the low-cost model (1979-1985) was characterized by an increased price competition, the new operators that entered the market during these years using various elements of the low-cost model.

In the *consolidation period* (1985-1992), a relatively high number of new entrant low-cost carriers from USA either withdraw from the market, went bankrupt or merged with the major traditional airlines.

Between 1992 and 1996 *new operators have entered* the low-cost airline market of USA, called "copy-cats" of the Southwest model.

The second consolidation stage occurred between 1997 and 2000, when the majority of the new entrants either went bankrupt, or were taken over in response to the crash of a ValuJet aircraft, in May 1996, which raised consumer concern in relation to the safety aspects of low cost airlines.

The market maturity is specific for the present American situation, where there are some strong low-cost airlines, such as Southwest or JetBlue.

In order to survive on the market, many of the low-cost companies tried to find out other ways to particularize their offer, due to the fact that the number of these operators has increased and the price does not represent a differentiation aspect anymore. In USA, four of the low-cost operators - AirTran, Frontier, JetBlue and Southwest - have already announced the intentions of extending their networks, by offering new services on the business market segment. On short and medium term there is no risk that the market of these operators declines because, according to a survey published in 2005 in Business Travel News, 73% of the airlines' clients that travel for business purposes argue that, in the future, they will continue to use the services offered by the low-cost carriers, at least with the same frequency (*Business Travel News*, 2005, pp. 8-10).

CASE STUDY: SOUTHWEST AND JETBLUE AIRLINES

Although Southwest entered the airlines market, in 1971, as a small low-cost operator, nowadays it is one of the biggest in USA. In order to transport almost 104 millions passengers per year to 64 destinations all over the world, the company has, daily, more than 3400 flights. Moreover, Southwest has the largest market capitalization of all the airlines in the world, greater even than the six traditional American operators, considered together.

The methods used in lowering the tariffs consist, mainly, in cutting costs through various procedures, in offering services with higher quality than other low-cost operators, maintaining a good ratio price-quality and, last but not least, in implementing an efficient management.

The Southwest's low costs are not based on low wages. Compared to any other US traditional airline, a great part of the Southwest employees are trade-union members and,

consequently, they are paid at the industry average revenue. The company's low costs are mainly based on the highly productive usage of its major aspects: aircrafts and employees.

It can be noticed the fact that Southwest used, during time, only one type of aircraft – Boeing 737 – fact that allowed a cost reduction not only in maintaining and repairing planes but also in trading the employees. The company considers that using only Boeing 737 offered the cockpit employees the possibility to know very well the plane and so to reduce at minimum the accidents' rate and to reach a performance in the operational safety.

Doing only point-to-point flights, served by small airports, allows each aircraft to be used more times per day – in average, 8 times -, with much smaller costs than operating connection flights through big international airports. The competitive advantage of small airports results from the possibility of attaining scale economies.

According to the remarks made by the Southwest officials, the company's flight staff perform more take offs and landings than any other airline in the world. This is possible due the fact that the company's philosophy consists in making the planes permanently flying – about 12 hours per day, in order to gain revenues as high as possible – and in having the fares low enough to keep people travelling. The Southwest managers also consider that the passengers will appreciate the elimination of the additional elements, such as business-class air-stations or catering services, as long as these economies will generate low prices. Yet, Southwest differs from the rest of low-cost operators through the fact that it currently offers minimum catering services, especially when the flight takes more than 3 hours.

Another aspect that has to be mentioned related to Southwest company, is that it uses the open seating system. This method seems to be very efficient first of all because there is no need for software to sort and hold seating assignments. Moreover, it saves time and money by eliminating the need for printing the boarding passes and then for verifying them as passengers boarded the aircraft.

In order to improve the performances of its aircrafts, Southwest implemented the Blended Winglets system. Its efficiency consisted in saving fuel, lowering engine maintenance costs and reducing takeoff noise.

From the very beginning, Southwest successfully applied methods and techniques of yield management, the principle that nowadays governs almost all low-cost airlines philosophy. In this way the company could notice the moments of the day when the demand was up, in order to practice higher tariffs, which were still about 20 times lower than the price of the traditional operators.

Another aspect that made possible the Southwest success was the development of 10 organizational practices in order to facilitate the coordination among the diverse functions existent inside the firm. These practices consists in: leading the organization with credibility and care, investing in the frontline leadership, hiring and training for relational competence, using conflicts to build relationships, bridging the work/family divide, creating boundary spanners, periodically measuring the global performances, keeping jobs flexible at the boundaries, making unions the company's partners, building relationships with the suppliers. As we can see, each of these practices is focused on building relationships of shared goals, shared knowledge and mutual respect, not only inside the firm but also with the external partners.

In what it concerns the JetBlue company, founded in 1999 and known nowadays also as "New Air", this became a global leader under many aspects: it was the first US airline that had the initial capital greater than 100 millions USD (130 millions USD), the first who offered 24 TV channels inside its aircrafts and the one that never used paper tickets.

As in the case of Southwest company, the JetBlue low costs and prices are mainly enabled by the types of the aircrafts used: only AIRBUS A320 and EMBRAER 190. The almost 100 AIRBUS A320 planes offer the customers wider seats and aisles, more overhead storage space and greater legroom than any other aircraft in its class. The advantage of the EMBARER 190 planes is given by the two engines that allow an efficient rationalization of the costs and time necessary to do

multiple flights during a day. A specific element for both types of aircrafts consists in the fact that they are not conceived to ensure various classes of seats, which allow the company apply an unique tariff for two tickets bought in the same day, for the same flight.

Considering all these aircrafts' characteristics, we can say that JetBlue offers not only low tariffs but also a better quality of the services than the other low-cost carriers. Some features particular to this operator, such as comfortable leather chairs, the check-in made through the internet, the possibility of watching 24 different TV channels during the flight, the fact that almost all its airplanes are new, determine us to say that JetBlue revolutionized the classical model of the low-cost operators, guided mainly by the price. Therefore, the customers choose the services offered by JetBlue not only because they are cheap, but also because they are better. We agree with the fact that the JetBlue model is a consequence of the increased global competition, caused by two factors: by the entrance on the market of a great number of low-cost carriers and by the intention of the traditional operators to reduce the tariffs for certain destinations. Yet, while these last companies have lower prices by eliminating some services offered before and, consequently, by cutting the quality, JetBlue, as well as some other low-cost companies, compete not only through prices, but also through value.

CONCLUSIONS AND FUTURE RESEARCH DIRECTIONS

The new competitive price structure established by the low-cost airlines had a strong impact on the traditional companies, which have lost large parts of their profits due to the rapid growth of the first ones. Yet, not all the low-cost airlines' markets have reached the same development stage. While in Canada, United Kingdom and Australia the market of the low-cost carriers is in the consolidation phase, in Asia and Eastern Europe it is only at the beginning, in the innovation stage, and in the Central Europe in the proliferation one. The greatest phase of development was reached up in USA, where the market of the low-cost carrier has already followed five stages - innovation, proliferation, consolidation, second phase of the new entrants and the second phase of consolidation - up to it's nowadays maturity stage.

Two of the most successful low-cost carriers from USA are Southwest and JetBlue. In both cases, the methods used in lowering the tariffs consist, mainly, in cutting costs and in maintaining a good ratio price-quality. The companies' low costs are based on the highly productive usage of two major assets: aircrafts and employees. In the case of Southwest, it could be noticed the fact that its performances were also enabled by the implementation of the efficient techniques of yield management.

An important aspect met at these two operators, but especially in the case of JetBlue, is the fact that they offer not only low tariffs but also a better quality of the services than other low-cost carriers. Actually, JetBlue revolutionized the classical model of the low-cost operators, guided mainly by price. In the nowadays context of increased competition, this aspect plays a great role in gaining market share, reason for which the low-cost airlines are forced to design their strategies considering not only the price but also the value as a significant criteria. Moreover, due to the fact that the number of these operators has increased and the price does not represent anymore a differentiation aspect, many of the low-cost companies tried to find out other ways to particularize their offer, in order to survive on the market.

These methods implemented by the low-cost airlines in order to differentiate them from other operators make the subject of another study started by us in October 2010 and conducted on a sample of six European low-cost airlines.

REFERENCES

1. Air Transport Association (2005) '2005 Economic Report', <http://www.airlines.org/files/2005AnnualReport.pdf>.

2. Brown Johnson, N. (2006) 'Airline Industry Council: Lean Production in the Air: Low-cost Competition Taking Off in the Global Airline Industry', *Proceedings of the 58th Annual Meeting Labor and Employment Relations Association Series*, Boston.
3. Diaconu, L. (2009) *Strategiile low-cost în contextul dinamicii pie ei mondiale*. Iasi: Al. I. Cuza University Press.
4. Doganis, R. (2001) *The Airline Business in the 21st Century*. London, New York: Routledge.
5. Francis, G., Humpheys, I., Ison, S., Aicken, M. (2006) 'Where next for the low cost airlines? A spatial and temporal comparative study', *Journal of Transport Geography*, 14(2): 83 – 94.
6. Groß, S., Schröder, A. (2007) *Handbook of Low Cost Airlines*, Schmidt Erich Verlag.
7. Lewis, C. (2003) 'Low-cost airlines make their move: as foreign flights get dropped, Southwest and JetBlue help fill the void', *San Diego Business Journal*, 24(29): 11-15.
8. Morrell, P. (2005) 'Airlines within airlines: An analysis of US network airline responses to Low Cost Carriers', *Journal of Air Transport Management*, 11(5): 303-312.
9. Morrison, S., Winston, C. (1995) *The Evolution of the Airline Industry*, Washington, DC: Brookings Institution.
10. Taneja, N. (2005) 'To Frill or Not to Frill', *Air Transport World*, 42(10): 34-37.
11. *** (2005) 'Fare rises limit fuel pain', *Airline Business*, 21(9): 11-14.
12. *** (2005) 'Getting aloft abroad: meet the foreign counterparts of American low-cost standbys JetBlue and Southwest', *Successful Meetings*, 54(12): 47-64.
13. *** (2005) 'Low/Cost Carriers Launching Slew of New Services', *Business Travel News*, 22(20): 8-10.
14. *** (2005) 'Airlines will go bust', *Travel Weekly*, nr. 1798: 22-31.
15. *** (2008) 'Low-Cost Airlines', *Air Guide Online*,
http://www.airguideonline.com/airgairlinelcc_news.htm.
16. *** (2006) 'No-fills airlines set to consolidate', *Travel Trade Gazette UK & Ireland*, nr. 2699: 17-26.

ACKNOWLEDGEMENT

This work was supported from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/1.5/S/59184 „Performance and excellence in postdoctoral research in Romanian economics science domain”.