

**Due:** February 18

Case Study: Big Airlines Cut Fares, Add Routes In Fight With Low-Cost Carriers

Low-cost carriers have low costs that allow them to be very aggressive on pricing—they do not have labor contracts like the Big Six—American, Continental, Delta, Northwest, United, US Airways—that keep their costs high. Moreover, low-cost carriers mostly have strong balance sheets and show quarterly profits to withstand expensive fare wars and capacity increases, while the cost structure of the big carriers is based on long histories, and did not account for opening the door to a new crop of airlines such as Southwest and JetBlue Airways during the consolidation process. Obviously, deregulation created an uneven playing field that has forced the Big Six to deteriorate over time. For the most part, major airlines use a hub and spoke network, whereas low-cost carriers do not and therefore can save money and offer lower fares. To sum up, these newcomers can really pay rock-bottom wages and set up work rules that favor the airline.

On the other hand, big airlines have some advantages through economies of scale in connection with frequent-flyer programs and strategic partners. And here is where the competition comes into play. The Big Six' reaction to the low fares is offering their frequent flyers free tickets on domestic or even international flights. In response to this move, the low-cost carrier JetBlue fires back by offering coast-to-coast travel for as low as \$79 one-way. However, these kinds of promotions are very costly and cannot be sustained over a longer period of time. Nevertheless, the big airlines can hope to undercut the rivals' offers and bring in some extra profits on routes that are not a market for the low-cost carriers—talk about cross subsidizing! But the price war or "war of survival" keeps going because of the flexible cost structure of the arising low-cost carriers and burns the big airline's cash vault or worsens their refinancing problems. This led big airlines to start with their own low-fare subsidiaries: Delta's Song and United's Ted. But for the Big Six to emulate the models of their low-cost competitors, they would have to change so much they would be not recognized anymore. They would no longer be the big airlines as we know them today.

The prime business routes had long been dominated by the old carriers. However, since the deregulation and the entrance of low-cost carriers the Big Six' profits have shrunk dramatically. And today's customers are no more willing or able to pay three times the price to fly from Boston to San Francisco just to be with American or Continental. Moreover, customer's preferences changed and they do not really care which airline they are flying with. Another pressuring point is the change in the business environment since the bubble at stock market burst three years ago. Businesses can no longer afford to buy their sales managers and executives' business class or economy class tickets. As a consequence of this economic slowdown firm policies changed in favor for low-cost carriers, which are offering the same routes as the big airlines, but for less money. As a reaction of this price skimming strategy of the low-cost carriers the Big Six are forced to drastically reduce their fares on routes where they face competition. In fact, this price war is unprecedented and will sooner or later come to an end but the big airlines do not want to miss a profit, and therefore the only strategy is to play the game and try to stay ahead!

One possibility is through the major airlines' frequent flyer programs that offer better deals and more ticket redeeming options. Furthermore, the big airlines have resources that the low-cost airlines lack: a world-wide network of flights and massive frequent-flyer programs whose reach is made even broader through strategic alliances with foreign airlines. Moreover, the Big Six provide comprehensive service across global networks and offer a wide variety of routes. In addition, these programs try to bond passengers, encourage frequent flyers with special offers, and can build a relationship with its first class customers, who are willing to pay for the service they get. Finally, another advantage of big airlines is when something gets wrong; they can just switch to different type of airplane, call different crew members or make the resources needed available.