Alexander Weissman

Professor Mary E. Deily

Eco 336

10/26/22

Antitrust Analysis of the Proposed JetBlue and Meta Mergers

The Antitrust world is an ever-changing landscape that can change the way we live our lives. No one wants another Gilded Age and yet no one wants business development to be unreasonably stifled, so there is a balancing act to be performed. The DOJ and FTC have established a set of merger guidelines which are used to assess any future mergers. The proposed JetBlue and Spirit merger is bound to be examined with the utmost scrutiny, owing to the high concentration of firms in the airline industry. It is my opinion, and most likely the FTC's as well, that the proposed merger should be blocked on the grounds that it will remove a maverick, give an external firm a functional monopoly on a part of the airline industry, and will raise the price of an airline ticket in the East Coast market.

Before the proposed merger can be examined, it is prudent to review the industry in which the merger will take place. According to Statista, the top four firms in the airline industry hold over 80% of the total market share (8), while the market has a HHI of around 1200, which has increased from around nine hundred since the turn of the millennia (see figure 1) (1). This is seen as an unconcentrated market according to the Merger Guidelines, but the top firms have and can exercise market power. The reason for the consolidation is that the airline industry has large economies of scale. Running an airliner is expensive in all aspects. The staff is filled with high skill laborers, whether that be pilots who require years of schooling, logisticians to ensure that all the routes are efficient and running well, and specialized engineers to keep the planes up and running. That is on top of, of course, the normal executives, marketers, accountants, and financial gurus that are necessary to keep a business of large scale running. Wages are by far the largest operating expense on JetBlue's statement of operations, which comes out to over 2.3 billion dollars (2). This issue is compounded by what is called by a former JetBlue executive, Martin St. George, "the dark secret of the airline industry" (12) which is that the only way to keep costs down is to grow, primarily because of the large wage growth of employees. The opportunity cost of replacing an older—and thus more expensive—pilot is 6 months of training, and in that time a potential route goes down, costing the firm. This opportunity cost gives pilots a large amount of leverage in wage negotiations, so it not uncommon for their wages to go up two or even three times from their starting salary in less than 15 years. This means that if new pilots aren't being hired constantly, and new routes not constantly being created, the cost of running an airline only increases as time goes on. However, even this is heavily outweighed by the capital requirements to run a firm in this industry. JetBlue has over 11 billion dollars of planes, hangers, and equipment on their balance sheet (2). On top of the previously mentioned expenses, JetBlue paid over 1.4 billion in fuel in 2021. All these expenses are on an airliner that only holds 5.4% of the market share. In industries with costs this high the optimal number of firms is always lower for the consumer to get the best price.

When deciding whether a merger can or should go through, the first and most critical step is defining the market. In doing so we must first examine what type of customers and markets these firms try to reach. In the airline industry there are three different markets that are serviced by different firms: Full-Service, Ultra Budget, and Hybrid. 20-30 years ago, there were only full service and budget (when JetBlue first came into the market), but that has since changed (12).

Full-service airlines make their money off higher fares and tend to service business fliers at a higher rate than lower cost airlines. Their larger nature also increases reliability. These airlines are characterized by flying to more international destinations, servicing Asia and Europe. Think Delta, United, or American Airlines for full-service airlines. The next category is Ultra Budget. As previously stated, the cost of running an airline only increases over time, so Ultra Budget eventually took over from Budget as it was able to innovate with unique price structures. Ultra-Budget primarily services leisure travelers, but also services the cost-conscious business travelers. Think Spirit, Frontier or Alaskan Airlines. The third and final operator in this market are Hybrid firms. The Hybrid firm attempts to take the customer facing approach that Full-Service firms take with a slightly lower price, somewhere between the other two categories. They target leisure customers primarily, but also have spaces for business travel as well. JetBlue is the only operator in this space, and they so far have not found much success in carving out a niche, as their stock as of this paper being written is $6.85 (market close 08-17-22) significantly below their IPO price of $13.33 back in 2002.

In the Merger Guidelines, there are two dimensions to defining a market: product market definition and geographic definition. In the product differentiation portion of the merger guidelines, when discussing market definition, the document states, “When a product sold by one merging firm (Product A) competes against one or more products sold by the other merging firm, the Agencies define a relevant product market around Product A to evaluate the importance of that competition. Such a relevant product market consists of a group of substitute products including Product A” (9). In assessing this merger, it must first be decided whether Spirit or JetBlue compete. To do so, the market positions of each firm must be examined. JetBlue calls itself a low-cost airline, but is it truly budget? No, it is not. Budget airlines are categorized by the

‘Spirit Model’ which revolutionized air travel in the 1990s. It theorized that many travelers only truly care about the destination, and not so much the journey, and thus offered the most limited travel package available. The cost to go to from point A to point B might only cost $49, but a carry-on bag is $20, snacks are $5, and there is little to no leg room. Spirit’s advertising is also pushing the notion of having the lowest fares, claiming to be the “home of the bare fare.” Their advertisements are also targeted towards younger people, making what are normally seen as taboo jokes and pop culture references, see figure 3. This is diametrically opposed to how JetBlue positions itself. According to Mr. St. George, “JetBlue positions itself as a fair fare airline that wins customers with its service.” On the same exact model of Airbus plane, that JetBlue and Spirit both employ, JetBlue has 20 fewer seats, increasing legroom by 11%. JetBlue is known for its inflight movie catalog, free Wi-Fi, and free snacks. JetBlue’s advertising stands in stark contrast to Spirit’s, as their tagline is “you above all” which can be seen right next to their logo. These advertisements are far more mature and corporate in nature, appealing to an older audience, see figure 2. Due to the fact that JetBlue is targeting the type of flier that likes to fly comfortably, it can be claimed with certainty that JetBlue and Spirit are not competing for the same customers, and thus operate in different markets.

The merger guidelines are concerned about geography affecting customers’ willingness to switch to a substitute good, and thus give the merged firms an advantage. JetBlue is based out of New York City, while also having strong hubs in Boston, Fort Lauderdale, Los Angeles, Orlando, and San Juan (3). Spirit on the other hand is based out of Fort Lauderdale and has hubs where JetBlue is relatively weak such as Dallas and Las Vegas. Both firms are based on the East Coast, and many of their flights go up and down along the Eastern Seaboard. Spirit services Latin America far more and JetBlue services the West Coast more. Frontier, Spirit’s Ultra-

Budget competitor, on the other hand, is based out of Denver and doesn't compete with Spirit on the East Coast. Due to the presence of larger, more dominant firms doing the same routes as Spirit and JetBlue, it can be confidently stated that a merger between the two wouldn't affect the price of a normal ticket for geographical reasons. However, removing the sole ultra-budget option on the East Coast will cause problems, which will certainly drive up the price for an airplane ticket.

The Ultra-Budget airline market is essentially a duopoly, with Frontier operating as the West coast option and Spirit as the East coast option. This is not to say that both airlines don't also fly on the other firm's coast, but in large they stick to their respective territory. If this merger were to go through this would all change. In the words of the JetBlue's CEO, Robin Hayes, "JetBlue plans to bring the JetBlue experience to all aircraft, offering JetBlue's combination of low fares and award-winning service" (7). Spirit is not being incorporated into the JetBlue system as a low-cost option, it is having its planes gutted and converted to JetBlue. This merger is fundamentally an acquisition of assets from Spirit to JetBlue. This in effect turns what was a duopoly in the Ultra-Budget market into a monopoly. This will have significant effects on the price of tickets for East Coast low budget travelers. Due to the extremely high entry barriers and the time it takes to set up a new airline—it takes 8 months to construct an Airbus A320 in normal supply conditions (10) —it is very likely that an enterprising firm, likely Frontier due to their current model, would come in and monopolize the Ultra-Budget market. Frontier is already doing this, adding 10 routes from Atlanta to international destinations on August 16th, less than 3 weeks after JetBlue and Spirit agreed to merge (4). Giving Frontier a monopoly would allow them to raise prices until they are just below the price of a non-budget airline, and still capture a large amount of the market.

Frontier invading East Coast airports would take years however, as the logistics are a difficult problem to solve. The next question is, what would this merger do to the price of a ticket right away? Simply put, it would raise the price. As previously mentioned, the capacity on a JetBlue Airbus A230 is 162, and the capacity of a Spirit plane is 182. New seats would have to be installed, causing an 11% reduction in the number of seats for sale. Thus, an 11% increase in price at least, not including the free snacks, Wi-fi, and other benefits the JetBlue model provides, would be necessary to keep the planes profitable. Assuming this takes a negligent amount of time to complete, after all the work is completed, there would be no longer be any budget options on the East Coast. If a customer wants to fly, they will have to go on any of the bigger full-service lines or JetBlue. Spirit operates as a maverick in the East coast market. If the other firms raise their prices too high, customers will fly on Spirit to save money. With this anchor on the price of an airline ticket removed, other firms could raise their prices as much as they wanted. Ideally JetBlue would act, as they have throughout their history, as a maverick firm and keep prices low, however the allure of higher revenue to an already high-cost firm with a history of low profits might be too hard to resist (2). As a market, East Coast flights are very likely to go up in price, leaving consumers in a much worse place.

The consumer gain from this deal, in the words of Mr. St. George are, “They (JetBlue) are going to increase your experience, because they can’t gain too much cost efficiency.” (12) As previously mentioned, former Spirit customers will face a higher price due to the conversion of the Spirit jets to the JetBlue model, but it is possible that even previous JetBlue customers could face higher prices as well. Increasing the number of routes, which will be made possible by the Spirit planes, doesn’t bring costs down, it simply increases profits. Having more pilots might allow JetBlue to put a cap on wages, but the airline industry faces a pilot shortage at the moment, and thus this seems unlikely to happen. Regarding staff, they intend to bring all of Spirit's staff to the JetBlue team (7). JetBlue, a company that pays over 2.3 billion in wages, is going to be taking on unnecessary employees, such as Spirit's accounting team, HR team, and service workers. These positions don't need to be scaled up to keep the operation going and will create organizational dead weight. The consumer benefit comes from an increase in reliability, as both airliners have problems with it. JetBlue's infamous 2007 Valentine's Day disaster, in which passengers where left on planes with no hope of taking off (12), was enough to cause the CEO to be fired and a Bill of Consumer Rights written (11). However, this may come at a higher cost than what consumers are used to.

After examining all the previous information, why did Spirit accept this deal? It provided the most value to shareholders, and in the buyout, JetBlue offered to pay $200 million if the deal doesn't go through due to regulatory activities (7). It is a win-win for Spirit shareholders. But why did JetBlue merge? Mr. St George said that it felt like a "defensive merger" as JetBlue fears that it will soon be bought out. Their growth is slow, their model is failing, and they feel as they can't compete with the larger companies. That is part of the reason they entered a deal with American in New York City, as JetBlue was getting beaten so badly in NYC, their home airport, by larger firms. The question of whether this merger should go through seems to be a simple one, with the answer being no. This merger will hurt consumers on price, as the cost of a JetBlue ticket will go up. This merger will also hurt consumers by offering Frontier a monopoly on budget travel in the United States. Finally, it will hurt consumers by concentrating the market on East coast travel and removing a maverick in that market. In both the long and short run consumers will get hurt because of this merger, and the efficiency gains are minimal, so there is no reason for this merger to be approved by the FTC or DOJ.

When comparing the JetBlue Spirit merger to the potential Meta-Within merger, a few notable standouts can be observed. JetBlue and Spirit are airline companies, an old economy industry. That is to say that their primary revenue comes from selling tickets, or in the modern airline industry, credit cards and. Meta is very much a new economy firm, and the economics powering antitrust laws in the new economy are very different than those which have governed the old economy. New economy firms are based on the internet, which is essentially the ultimate network, and thus companies based in it create a larger degree of network externalities. In the new economy, the more customers you have, the larger the network is, and thus the larger the consumer value is for being a part of the network. In a hypothetical new economy market, the moment that one firm gains an advantage, suppose they have a new feature that everyone loves, people will move from the firm without the feature to the firm with it, as the entry barriers are so low. Most already have a device that can access both apps, so the switching costs are so low. If one firm gains a competitive advantage, it is very possible for a firm in competition to die and be left behind if they don't adapt. This is why Instagram, a company owned by Facebook, adopted Stories which they copied from Snapchat, Reels which they copied from TikTok, and Live which they borrowed from Facebook. To stay relevant in the new economy a firm must live on the bleeding edge.

Meta, which used to be Facebook before they changed their name in 2021, has been attempting to build a network in virtual reality with their 'Meta Quest' VR headsets. This is attempting the same method they used to build Facebook, by buying their competition. Facebook has merged with 78 companies up to today in order to build their network, with the standouts being Instagram and WhatsApp, which Meta paid a combined $20 Billion for. They have continued this with the leap into the virtual reality world acquiring Oculus, an industry leader, and many top developers in the space (5). This has been done in an attempt to make the Meta Quest platform the premier virtual reality network with the best apps, thus attracting the most users.

The FTC’s injunction is based on the very notion that Meta has bought its way to the top. The reason this was described as “highly unusual” is that new economy mergers are a very common thing. When Facebook acquired Instagram in 2012, they attained near monopoly status in the photo sharing market, and yet the FTC cleared the deal. The FTC is now objecting because they believe that Meta is attempting to buy out competition, as Supernatural competes with Beat Saber, an app that meta acquired. They are also alleging that Meta could develop their own fitness app to compete with Supernatural and doing so would be best for the consumer by spurring competition (7). The FTC is interfering with the merger in an attempt to keep Meta from building a network which, in the words of Mark Zuckerburg, is “completely ubiquitous in killer apps” (7). They believe that competition in the VR world is a better state of the market in the long run. Another reason this is bizarre is that it is a forward-thinking injunction. Throughout history, antitrust authorities have been a step behind the business world. This is due to the long time it takes to bring a firm to trial, and often by the time a decision is reached the result is insignificant. This is safeguarding a market that is not yet large, but has the potential to be, especially in the eyes of Meta.

As a potential consumer in this space, I agree with the FTC’s notion that no one firm should dominate the virtual reality space. My ideal virtual reality market has competition in hardware, while software is more open source, the same way firms compete in other gaming spaces. While Xbox and PlayStation have their own games produced in house, a majority of games are cross platform and can be played no matter what console the player has. These moves show Meta attempting to “strangle the VR market in the crib” and kill a potential competitive market. Over the past 20 years tech companies, especially meta, have garnered immense market power via growth and mergers, so much so that there have been many controversies over how Facebook affects people’s decisions. The 2016 election controversy is a chief example of this, where in certain people accused Facebook of spreading “Fake news” which allowed for the election of Donald Trump (13). While it is true that increasing the value and the size of the network brings more value to the consumer, it is also true that one firm should not be able to dominate one technological sector, especially a sector as new as virtual reality. If Meta were to gain a functional monopoly on virtual reality, aided by their dominant social platforms and messenger services, innovation by competition is certain to slow down. Meta owns the market in which VR apps can be sold, and thus could host Supernatural and other competitors on its app store without owning the firm. Through the lens of a consumer there is no benefit from Meta attaining market dominance in another market as they do in social media, and thus I would like the merger to be blocked. Blocking this merger could serve as a message to other large tech firms that buying your way to the top won’t work anymore, and that they will have to compete using their vast resources that they already have, which will help stimulate competition and perhaps bring more firms in to the tech industry.

Figures:

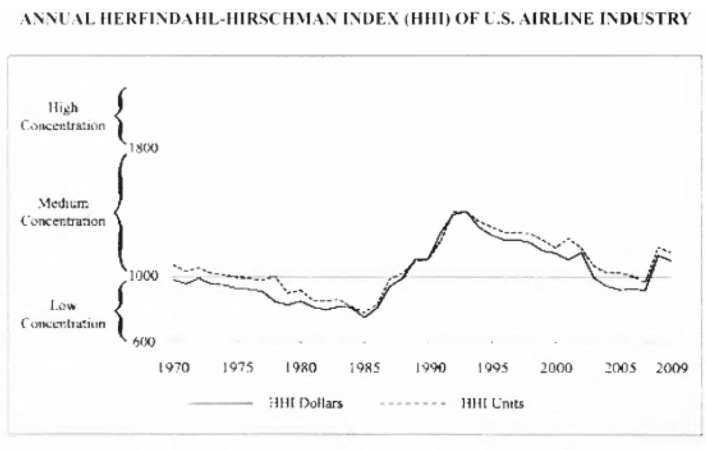

Figure 1: HHI of airline companies over time

https://digitalcommons.wayne.edu/cgi/viewcontent.cgi?article=1096&context=jotm

JetBlue Ad

Figure 2: Example of a standard JetBlue Advertisement

[Spirit Ad]

Figure 3: This Ad displays the more vulgar nature of Spirits ad campaign

Bibliography

1) Grullon, Gustavo, et al. “Are U.S. Industries Becoming More Concentrated? .” *Mendoza.edu*, Mendoza University, Aug. 2017, mendoza.nd.edu/wp-content/uploads/2019/01/2017_fall_seminar_series_gustavo_grullon_paper.pdf.

2) JetBlue. “Annual Report 2021 - JetBlue.” *JetBlue Investor Relations*, 21 Feb. 2022, mediaroom.jetblue.com/~/media/Files/J/Jetblue-IR-V2/Annual-Reports/jblu017-jetblue-2020-annual-report-web.pdf.

3) JetBlue Investor Relations. “JetBlue Focus Cities.” *JetBlue-Focus-Cities-2019*, JetBlue, 2019, 3 investor.jetblue.com/~/media/Files/J/Jetblue-IR-V2/fact-sheet-documents/jetblue-focus-cities-2019.pdf.

4) Thomaselli, Rich. “Frontier Airlines Adding New International Routes from Atlanta.” *TravelPulse*, Trending in Travel, 16 Aug. 2022, www.travelpulse.com/news/airlines/frontier-airlines-adding-new-international-routes-from-atlanta.html.

5) Bose, Shruti. “Facebook Acquisitions – The Complete List (2022)! [Infographic].” Https://Www.techwyse.com /Blog-New/, Techwise, 17 Feb. 2022, www.techwyse.com/blog/infographics/facebook-acquisitions-infographic/.

6) Staff, the Premerger Notification Office, and DPIP and CTO Staff. “FTC Seeks to Block Virtual Reality Giant Meta's Acquisition of Popular App Creator Within.” Federal Trade Commission, United States Government, 27 July 2022, www.ftc.gov/news-events/news/press-releases/2022/07/ftc-seeks-block-virtual-reality-giant-metas-acquisition-popular-app-creator-within.

7) Staff, BuisnessWire. “JetBlue and Spirit to Create a National Low-Fare Challenger to the Dominant Big Four Airlines.” Business Wire, Berkshire Hathaway, 28 July 2022, www.businesswire.com/news/home/20220728005527/en/JetBlue-and-Spirit-to-Create-a-National-Low-Fare-Challenger-to-the-Dominant-Big-Four-Airlines.

8) Salas, Erick Burgueño. “U.S. Domestic Market Share of Leading Airlines.” Statista, Statista, 27 July 2022, www.statista.com/statistics/250577/domestic-market-share-of-leading-us-airlines/.

9) “Horizontal Merger Guidelines (08/19/2010).” The United States Department of Justice, Department of Justice, 25 June 2015, www.justice.gov/atr/horizontal-merger-guidelines-08192010.

10) 11:03, cooper atkinson 10/06/2022 at, et al. “Airbus A320 Introduction.” Modern Airliners, 14 Oct. 2022, modernairliners.com/airbus-a320-introduction/.

11) Schlangenstein, Mary, and Leah Nylen. “JetBlue's $3.8 Billion Spirit Deal Faces Tricky Antitrust Review (JBLU, Save).” *Bloomberg.com*, Bloomberg Publications, 29 July 2022, www.bloomberg.com/news/articles/2022-07-29/jetblue-s-3-8-billion-spirit-deal-faces-tricky-antitrust-review.

12) St. George, Martin. Interview. Conducted by Alexander Weissman. 17 October 2022

13) Kurtzleben, Danielle. “Did Fake News on Facebook Help Elect Trump? Here's What We Know.” NPR, NPR, 11 Apr. 2018, https://www.npr.org/2018/04/11/601323233/6-facts-we-know-about-fake-news-in-the-2016-election.