GroupP

(Case Study of SreyDin)

In July 2008, American Airlines (AA) was the largest air carrier in the world, and it competed against five other established U.S. airlines as well as newer airlines such as Southwest and JetBlue. Then, oil prices, which are approximately 35% of an airline's total operating costs, were rising, and the recent financial recession occurred that led to a significant decrease in the number of business travelers (who are the most lucrative source of revenue for an airline). These circumstances led to billions of dollars in losses for most major U.S. airlines, including American and JetBlue. Southwest, however, was the exception because it has always pursued a cost-leadership strategy and so had been able to withstand falling ticket prices and rising costs better than the older, more established airlines. With many major airlines facing bankruptcy, the Justice Department began to look more favorably upon requests by airlines to merge their operations, expand their route structures, and reduce their cost structures. The downside for passengers of merger and horizontal integration, of course, is that if there are fewer airlines, the remaining carriers are able to reduce the number of flights they offer and services they provide—and the result is that ticket prices increase. For example, industry consolidation makes it easier for carriers to announce changes such as charging for a second checked bag or the right to be seated first, all of which provide airlines with additional sources of revenue. Nevertheless, in 2009 the Justice Department allowed Delta and Northwest Airlines to merge, resulting in the new Delta becoming the largest U.S. airline. Then in 2010, the merger between United and Continental Airlines was also approved, and by 2011, the newly merged United-Continental Airlines was competing with Delta to become the largest U.S. carrier. American Airlines, by that time, was now number three after its proposal to merge with British Airways (and become the largest global airline) was not approved for antitrust reasons—despite that the global airline industry was also rapidly consolidating. By 2011, the largest U.S. airlines had achieved most of their goals of reducing costs; they had slashed the number of flights they offered, mothballed hundreds of older planes, laid off thousands of employees, and instituted new surcharges for fuel, baggage, and even for carrying pets onboard. In 2012, Delta and US Airways posted modest profits (Delta earned a net profit margin of 2.4% and a return on assets of 2%; US Airways earned a net profit margin of 4.6% and a return on assets of 6.8%). United-Continental and American Airlines, however, were still posting losses. While its rivals had lost many billions over the decade beginning in 2000, Southwest celebrated an unbroken string of consecutive annual profits. By 2011, Southwest served most major U.S. cities, and its managers also saw an opportunity to expand market share and simultaneously keep its cost structure low by acquiring one of its low-cost rivals, Air Tran Holdings, owner of AirTran Airways. AirTran offered low-cost passenger transportation to almost 70 cities, mainly in the United States and the Caribbean. Like Southwest Airlines, it operated an all-Boeing fleet, facilitating its integration with Southwest's operations (Southwest's use of only Boeing 737s was said to be a major source of efficiencies, for example, by reducing parts inventory requirements and increasing pilot flexibility). The revenues of the combined companies reached $17.1 billion in 2012, roughly half the size of the world's largest airlines. Many analysts, watching Southwest's everchanging online fares, noted that it, too, was raising fares in response to the moves of other airlines. Although it had staunchly refused to impose baggage fees (in order to not erode its low-cost image), it began to create fees for such services as bringing pets into the cabin and for the travel of unaccompanied minors.