

The six C's of modern airline competition

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ABSTRACT This paper discusses a wide variety of forms which modern-day airline competition is taking – The six C's, including competition, coopetition, codesharing, coordination, cooperation and anti-trust immunised relationships (collusion) – and makes some observations about what this requires of us and some of the requirements it will impose upon our revenue management systems. In particular, they create the need for better ways to share data, to optimise across multi-carrier networks and to understand the economic implications of these relationships.

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INTRODUCTION

The nature of airline competition is changing, and the implications for airline revenue managers are changing, as well. This paper will discuss a wide variety of forms which modern-day airline competition is taking – The six C's – and makes some observations about what this requires of us and some of the requirements it will impose upon our revenue management systems.

WHY IS COMPETITION CHANGING?

The primary motivations for the new competitive scenarios are related to scale economies. These can be found in traditional efficiencies of size, resulting in fixed costs shared across multiple carriers. But just as importantly, they are driven by the so-called 'network effects,' the

benefits that accrue to an airline through ubiquity. Ubiquity, or the ability of an airline to portray itself as 'flying everywhere,' serving all of the travel needs of their customers, is increasingly important in creating an attractive frequent flyer programme proposition, as well as in negotiating corporate relationships, travel agency relationships, global distribution systems relationships and so on. As we will see, both the cost-efficiencies of scale and the network benefits of scale are instrumental in motivating many of the competitive behaviours that we will examine here.

THE FIRST C – GOOD OLD-FASHIONED COMPETITION

Before we dive into the five variations, there is still a place in this industry for straight-up competition: where airlines try to out market,

out serve, out price and generally out-perform the other guy to win in the marketplace. This is the kind of competition that motivated Alfred Kahn and other 1970s' economists to deregulate the US airline industry. They envisioned an industry in which many airlines would compete with each other, driving down prices and driving up service and driving the weaker players out of business. Price and quantity would vary to bring the industry into supply/demand equilibrium, with successful firms earning a fair return on investment. Oh, wish it were so.

Instead, a combination of factors – very high fixed costs and very low marginal costs, total product perishability, joint production of products (that is origin/destination markets) across the network, uneconomic investment in the business (undoubtedly because of its glamour!), and the value of ubiquity (which undercuts the economists' theoretical cap on the economic firm size) – have contrived and conspired to create an industry that only makes money on fuel hedges.

So, with a theoretical economic model of perfect competition that does not seem to work, airlines set out to find one that does. And here is what they have tried.

THE SECOND C – COOPETITION

Coopetition, or finding mutually productive ways to do business with your competitor, has been around the airline industry for a while, but it is growing. Among the coopetition behaviours that airlines engage in include:

- Selling ground services to each other
- Selling computer software programs to each other
- Sharing aircraft parts inventory
- Co-owning various industry consortia
- Selling seats on each other's flights
- Accommodating each other's passengers (for a fee) in off schedule operations
- Negotiating Special Prorate Agreements (SPAs)

- Sharing safety data and procedures
- Writing papers for publication in industry journals.

THE THIRD C – CODESHARING

In the 1980s when airlines began to put their code onto other airlines' flights and to sell them as if they were their own, American's legendary CEO Robert Crandall protested to the US Department of Transportation that the practice was deceptive, that its intent was to fool a customer into thinking that they were buying an online connection when it was, in fact, an interline connection with all of the associated risks and pitfalls. DOT ruled, however, that codesharing was beneficial to the public, so long as a few simple consumer protection procedures – mostly about how the flights were tagged in the schedule displays and offered to the customer by reservations and travel agents – were followed. With that, airlines (including American Airlines) were off to the races.

Today, there are literally hundreds of codesharing deals out there. They include commuter partners (both owned or under contract), bilateral domestic codesharing partners, bilateral international codesharing partners, multi-lateral alliance partners (either with or without antitrust immunity, ATI), and 'Have flights, will codeshare' airlines that have relationships with many airlines to share their whole network with multiple carriers. In addition, these various codesharing relationships can come with or without frequent flyer programme exchange.

THE FOURTH C – COORDINATION

Coordination of activities can take place in different forums, for a variety of purposes. It can occur under government supervision, such as congestion delay programmes; at an airport, such as re-arrangement of gate assignments (especially to get partners together in the same terminal); or can involve coordination of sales offerings to customers. The latter can be easily



coordinated between ATI partners, but can also be arranged via 'blind coordination' between nonimmunised partners who are unable to see their 'partners' submissions.

THE FIFTH C – COOPERATION

Cooperation between airlines takes place in many arenas today. There are organisations that facilitate joint lobbying on issues of importance to the industry as a whole. These include:

- Improvements to the Air Traffic Control System
- Efforts to reduce the tax burdens on airlines and their passengers
- Guidance on the development of Federal Air Regulations
- Attempts to steer sensible legislation (and steer away from nonsensical legislation) governing the rights of passengers.

In addition, there are times when airlines find themselves as co-plaintiffs in lawsuits, such as against airports' attempts to impose overreaching fees or when states pass laws that preempt Federal jurisdiction in matters of interstate commerce.

More and more airlines are cooperating on joint purchasing arrangements, combining their purchasing needs to form a bigger, more powerful buying coop. And alliance partners are cooperating on alliance branding, advertising the alliance (*oneworld*, *Star*, and *Skyteam*) and on common customer processes and procedures.

THE SIXTH C – COLLUSION

I refer to this last category as collusion – tongue firmly planted in cheek – because it begins with a C, but what we are really talking about here are government-sanctioned price and schedule coordination and/or joint ventures. These include a range of tightness, from the near-total merger of Air France and KLM, to the virtual merger of AF/KL with DL/NW, to the close coordination of UA/LH to the geographically limited coordination of BA/QF.

These relationships can involve organisational mergers ... or not. They can display varied levels of shared decision-making, and they may or may not involve revenue pooling.

IMPLICATIONS

These forms of competition create a variety of new problems and challenges for airlines, who now find themselves partnering with their competitor ... and/or competing with their partner. There are many data issues, as airlines sort out how to share what needs to be shared – and only that – in order to service their partner's customers or to coordinate shared inventory of codeshare flights. There are also challenges associated with potential traffic cannibalisation, as partners compete to keep as much traffic on their own metal as possible – unless a joint venture structure makes that moot – without jeopardising the partnership.

RM SYSTEMS IMPLICATIONS

There are a number of systems needs to which these competitive dynamics give rise. So far, the revenue management (RM) IT community has been slow to recognise these needs and fulfill them. These include:

- Alignment of inventory across partners
- Network optimisation across partners
- Data sharing
 - Passenger name record servicing
 - Protection against customer poaching
 - Coordinated customer relationships management efforts
- Better understanding of ubiquity effects
 - S-curves – the relationship between city-pair frequency share and traffic or revenue share
 - City (as opposed to city-pair) presence – the power of having broad schedule presence in a city
 - Corporate dealing market power – the ability to command premium corporate

- traffic share or to provide smaller discounts based on network strength
- Online network growth in the age of diminished interlining – the ability to serve customers’ whole trips
- Frequent flyer ties
- Multi-stop itinerary (that is three or more one-way trips) impacts
- Analysing the economics of these new relationships
 - Models to determine the benefits of one’s own alliances
 - Merger
 - Alliance membership
 - Codeshare agreements
 - Frequent Flyer programme reciprocity
 - Interline agreements/SPAs
- Models to determine the impacts of competitors’ alliances.

A FEW SUGGESTIONS

In this new world, it is clearly necessary to have the RM systems and tools that are

outlined above, but it is also important to do some less technical, but no less important learning. First, in many companies and for many relationships, it is necessary to learn how to use ‘Chinese Firewalls,’ to cordon off parts of the organisation who can know necessary details about a partner, but who will not share those details outside of the intended purpose.

Second, these relationships require great sensitivity to the antitrust laws, to ensure that you never – even inadvertently – cross the boundary and venture into discussions or exchanges that are not permitted. A good relationship with your legal department, which is hopefully well trained in such matters, is necessary, and you are well advised to confer with them before, during and after engaging in discussions with competitors.

This may be a cliché, but you are looking for win/win relationships ... at least at the macro-level. This may require you to not sweat some of the small stuff, but keep your eye on the bigger prize.

And finally, get used to it. These complicated competitive environments are here to stay.