

1-1-1984

Deregulation and the Marketing of Airline Carriers

J.A. F. Nicholls

Florida International University, hospitality@fiu.edu

Follow this and additional works at: <https://digitalcommons.fiu.edu/hospitalityreview>



Part of the [Hospitality Administration and Management Commons](#)

Recommended Citation

Nicholls, J.A. F. (1984) "Deregulation and the Marketing of Airline Carriers," *Hospitality Review*: Vol. 2 : Iss. 1 , Article 6.

Available at: <https://digitalcommons.fiu.edu/hospitalityreview/vol2/iss1/6>

This work is brought to you for free and open access by FIU Digital Commons. It has been accepted for inclusion in Hospitality Review by an authorized administrator of FIU Digital Commons. For more information, please contact dcc@fiu.edu.

Deregulation and the Marketing of Airline Carriers

Abstract

No student of the hospitality industry can long be insensitive to the role of air transportation in creating much, though by no means all, of the "place demand" for his industry. This article confines itself to a discussion of the impact of deregulation on carriers in the industry and discusses implications for the hospitality field

Keywords

J.A.F. Nicholls, Airlines, Air travel, Discounting, Deregulation, Eastern Airlines, Braniff Airlines, CAB, IATA, FIU

Deregulation and the Marketing of Airline Carriers

by
J.A.F. Nicholls
College of Business Administration
Florida International University

No student of the hospitality industry can long be insensitive to the role of air transportation in creating much, though by no means all, of the "place demand" for his industry. This article confines itself to a discussion of the impact of deregulation on carriers in the industry and discusses implications for the hospitality field.

For many years following World War II, there was virtually no economic competition between airlines flying particular paired routes in the United States and abroad. For domestic routes, the Civil Aeronautics Board (CAB) provided tight economic regulation; the International Transport Association (IATA) did so for international routes. Price competition was virtually nonexistent. Route prices were approved by the CAB or by the IATA. It was a warm and cozy oligopolized world for air carriers. Prices were a given, seldom discounted; traffic increased steadily with the "majors" dominating domestic routes and a select few flag carriers—mostly from America and Western Europe—emerging as the high volume international ones.

Rivalry between airlines did not involve ticket prices. Passengers were provided steak dinners or complimentary champagne, wide passenger seats or more leg room, glossy airline magazines, etc.¹ As Sir John Hicks, a Nobel laureate in economics, once remarked in his classic discussion of the benefits of cartels and other forms of monopoly, the main benefit was "a quiet life." There was no need, as the competitive model might suggest, to get up earlier in the morning, go to bed later at night, and strive hard to get ahead or stay there.

Domestic Deregulation Provides a Choice

Today there is a choice in domestic flying: the brown bag or the red carpet. If you are not willing to haul your own luggage or pay a \$3 fee for each piece of baggage you check in, provide your own lunch, and fly to and from nontraditional airports in unglamorous circumstances and surroundings on, as it is said, older model aircraft, then you can fly Eastern or one of the "major" carriers. (A major or "trunk" carrier is defined as being an airline with revenues greater than \$1 billion a year. There are, with the recent rebirth of Braniff, currently 12 such major airlines in the United States). The watershed for the domestic trunk lines came in 1977-78. Air cargo was deregulated in 1977; passenger deregulation was set in motion, on a progressive basis, in 1978,

with the probable elimination of the CAB anticipated for the mid-1980s.²

The Humpty-Dumpty world of the major airlines was shattered following these acts of deregulation. The trunk airlines, even the financially strong and well-managed ones such as Delta and United, have been suffering grievous losses since 1979 when lean and mean carriers broke into their once lucrative cartel. Braniff went belly-up; Continental is going through a major Chapter 11 reorganization and Eastern appears to be suffering from hemophilia.

Should you choose to fly People Express, expect a crowd. This low-cost airline has consistently had a seat load factor of better than 80 percent. (An airline's seat load factor is the number of passenger revenue miles as a proportion of the number of available passenger miles). Should you choose to fly Eastern, you will be able to assume a pasha position. In 1983, the airline had a seat load factor of 59 percent, in 1982, 56.6 percent.

Other majors fared equally poorly. For instance, in 1983 Delta generated 26.8 billion revenue passenger miles and had 49.5 available passenger miles for a seat load factor of 54.1 percent; in 1982 it was a 54.3 percent seat load factor. For Piedmont, it was 5.1 billion revenue passenger miles, 9.5 billion available passenger miles and a seat load factor of 53.7 percent in 1983; 3.8 billion revenue passenger miles, 7.0 billion available passenger miles and a seat load factor of 54.3 percent in 1982. For all major airlines, revenue passenger miles were 241.6 billion in 1983, available passenger miles 397.9 billion and a seat load factor of 60.7 percent; in 1982 their revenue passenger miles were 223.6 billion, available passenger miles 378.4 billion and a seat load factor of 59.1 percent.

A 55-60 percent seat load factor before deregulation would have resulted in a handsome return to the highly geared and coddled carriers under the watchful and solicitous eye of the CAB. In the deregulated domestic industry, this is no longer true; in fact, changed circumstances have shifted the financial gearing against the majors.

New Carriers Are Unaffected

Several concomitant factors have brought about the change; together their impact on the majors has been devastating. The new carriers have been virtually unaffected. The basic problem for the trunk carriers is that the revenue variables for the airlines are no longer as predictable as they once were under the CAB's administration. Stephen G. Breyer, now a judge on the First Circuit Court of Appeals in Boston and in 1974 a Harvard law professor who helped organize Sen. Edward Kennedy's Senate Judiciary Subcommittee's hearings on airline deregulation, remarked that the "classical CAB regulation continued forcing carriers to charge well over \$1,000 for cross country flights."³ Cross country flights, as another subcommittee witness put it, were only 37 percent full. "The business traveler may be pleased to find an empty seat on which to put his briefcase. Would he be so pleased if he realized he was paying full fare for the briefcase?"⁴

Even at 37 percent load factors, the regulated airlines could, and did, make money when seat prices were \$1,000 each, discounting min-

imal. What has happened is that the intersection of economic growth, demand, and yield is now unstable. The major airlines, with heavy fixed costs inherited from their days of regulation, are in no state to fight off their new breed of deregulated competition. The major benefit of a cartel may be a quiet life; it also tends to make its members flabby.

The majors are stuck with overcapacity, bloated labor costs, and high interest and fuel charges. Their new competitors are small and nimble. It is rather like the Fourth and Fifth centuries when the Huns, those lightweight, immensely agile, prairie horsemen, took on the heavily armored, but ponderous Byzantine cataphracts; even though outweighed, the lightweight troops were simply able to maneuver their unwieldy opponents and slaughter them. So long as they chose their ground, there was no contest.

Even with load factors in the middle to high 50s, Eastern is losing money hand over fist. Economic growth has been relatively stagnant since 1979, though improving quite recently. Even though passenger demand will increase with economic growth, it no longer generates the yield that it did in the 1960s and 1970s. The available passenger supply of seats, as the overall figures for the majors indicate, has increased from 378.4 billion to 397.9 billion available passenger miles, a 5.2 percent increase from 1982 to 1983. Even though revenue passenger miles have increased 8.2 percent in that same time period, growth has not overcome either the 1979-82 losses nor, more importantly, the sharp drop-off in yield.

To hang on to their load factors, majors flying the dense north-east to south-east corridor routes have been trying to meet their \$23 (Newark to Washington), \$69 (Newark to West Palm Beach), and \$99 (Syracuse to West Palm Beach) competition head-to-head. Even Delta, an airline which in the past has refused to be drawn into rate wars, has entered the fray. The alternative is too ghastly to contemplate. Better to fly with seats yielding up to \$99 a trip on major routes than be flying empty seats at \$149 or \$169 each.

At \$100 or less per seat/trip, the new carriers can still make money. Flying at better than 80 percent capacity, People Express made an operating profit of \$10.6 million in 1982. People Express was flying DC-9s, bought second-hand for a song, between low-rental airport sites. People Express minimized passenger services, charging for most of those that it did provide. Employing a non-unionized labor force, whether composed of pilots, flight attendants, mechanics, or other ground personnel, the airline had more flexible work rules.

Eastern Provides a Contrast

Eastern, in contrast, flies between prime real estate, paying the going rates at the various international airports to which it flies; Eastern has a fuel-efficient, up-to-date fleet of A300s and 767s, together with some older aircraft like the L1011s which it has sold, or is attempting to sell, to Third World countries, or elsewhere. A Boeing 767 is a \$40 million plane. Any time it is sitting idle on the ground, it is not repaying its purchase price.⁵ Even an elementary opportunity cost analysis dictates that it should be flying as long as it covers its mar-

ginal costs. On the other hand, the fact that it adds to capacity in a market where supply exceeds demand simply adds to the discounting potential.

The *Economist* estimated that discounting reached some 80 percent of all fares offered in America in October 1982.⁶ The average discount mounted to 53 percent of full share, with some discounts rising as high as 70 percent. Besides, in its effort to keep a modern, fuel-efficient fleet, Eastern Airlines is in debt to the tune of more than \$2 billion due to its recent purchases. In 1982, Eastern paid out some \$178 million in interest payments as a consequence. In that same year, Eastern incurred operating losses of \$18.8 million. By 1983 these operating losses had escalated to some \$405.1 million, reduced to \$183.7 million by the judicious sale of tax credits. The need for a whole-blood transfusion appears imminent to many observers.

Another reality is dawning on the trunk carriers. When the low-cost carriers first entered the various markets that they had targeted, the majors viewed them as a gnat-bite annoyance, but no serious threat. This view is rapidly dispersing as the winds of change blow through their once orderly citadel. People Express had merely 20 planes on its north-east to south-west route structure at the beginning of 1983. By the early autumn of that year, it was up to 32, with a growth to 67 jets projected by 1985.⁷ Southwest Airlines, another aggressive, low-cost competitor operating out of Dallas, is projected to grow from 25 aircraft at the beginning of 1982 to an estimated 56 in 1985.⁸

Their increased capacity is causing these airlines, together with others such as Muse Air, Midway Airlines, and New York Air, to seek new routes. Muse Air, aided and abetted by Southwest Air, almost single-handedly destroyed the Continental and Eastern duopoly from Houston to Los Angeles, where the one-way coach fare for the two majors was \$300. Then Muse and Southwest entered the fray. Muse dropped its fare progressively from \$145 in April to \$99 in May 1983. Now there is a further threat to the majors; low-cost carriers like People Express are talking about entering the coast-to-coast markets. Donald Burr, founder and chief executive of People Express, is openly talking about a New York to Los Angeles or San Francisco fare of between \$99 and \$119 later this year. The current regular coach price is \$433. A seat booked weeks in advance, requiring a "red-eye" (overnight) flight, goes for \$189.⁹ The threat of yet another price war is causing collective corporate shudder among the trunk lines.

Marketing Is the Key to Change

Can nothing be done by the major carriers about this disruptive price situation? On a price basis, the answer seems to be a resounding "No!" The dilemma, recognized by a vice president at one major airline, is "Either we don't match and we lose customers, or we match and then, because our costs are so high, we lose buckets of money."¹⁰ Michael Muse, president of the airline named after him, puts the dilemma more pithily when he says, "If you don't match, it's like slashing both wrists."¹¹

What is emerging is a groping movement toward new marketing approaches. The key current one is aimed at the frequent traveler, the

business traveler who tends to pay full fare and is unable to book, usually, sufficiently in advance to get the benefit of lower cost carriers. These frequent traveler programs were begun a little more than two year ago and elicited considerable response from the business flyer.¹² Although plans vary in detail, there are considerable similarities between them. If a traveler flies, for instance, from 2,000 to 10,000 miles with a particular airline, he may be eligible for having his ticket upgraded from coach to first class. Travel over 50,000 miles may bring the reward of free first-class tickets. Travel even greater distances, and the frequent traveler may secure goodies like automobiles or expense-paid cruises for two.

The program is clearly working, even if it is causing some corporate headaches, as employees are having themselves sent along bizarre routes in order to rack up a few more miles with a particular carrier and its awaiting prize.

The interesting point about the frequent traveler strategy on the part of the major is that it appears to be eliciting results. It also addresses, through some creative marketing, a nub of their current problem. The business travel market tends to be relatively concentrated, being composed of few travelers flying a relatively large number of trips. Demand for this portion of the market tends to be firm. Consequently, although the business travel market accounts for a small, but relatively stable, proportion to total airline journeys, it provides a considerably higher proportion of airline revenues. Aside from the approach taken by Continental recently, or a modification thereof—that is, slimming and trimming a major airline by reducing labor costs significantly, probably through abrogation of union contracts—the frequent traveler program is one feasible marketing strategy for the major to adopt against its low-cost rivals.

Hospitality Industry Is Affected

In the sense that deregulation has resulted in much lower airfares on specific routes, one conclusion is clear for specialists in hospitality services. Passenger traffic between cities linked by low-cost carriers, almost invariably connecting major urban areas which have become prime demand locales for hospitality services, is going to steadily increase. In the longer term, of course, cities served by lower-cost airlines will probably begin to develop a wider range of hospitality services, to the detriment of those, often in specialized resort regions, which do not enjoy the benefits of lower-cost air fares.

Footnotes

1. *The Economist*, May 28, 1983, p. 5.
2. Donald F. Wood and James C. Johnson, *Contemporary Transportation*, 2nd edition, (Tulsa, OK: PennWell Publishing Co., 1983), pp. 287-289.
3. Lindley H. Clark, Jr., "Speaking of Business," *The Wall Street Journal*, November 22, 1983, p. 35
4. *Ibid.*
5. *The Economist*, *op.cit.*
6. *Ibid*, p. 7.
7. William M. Canley, "Rough Flying," *The Wall Street Journal*, October 12, 1983, pp. 1, 23.
8. *Ibid.*
9. *The Economist*, February 4, 1984, pp. 71-72.
10. Canley, *op.cit*
11. *Ibid.*
12. This discussion is based on Harlan S. Byre, "Airline Prizes for Travelers Spur Dilemma," *The Wall Street Journal*, October 5, 1983, pp. 31, 50.