PRICING THE AIRLINE INDUSTRY

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Short Description
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Description

PRICING THE AIRLINE INDUSTRY CAST STUDY solution

Read and analyse the following case and answer the questions given at the end.

PRICING THE AIRLINE INDUSTRY

For the first 15 years after deregulation in 1978, the U.S. airline industry was plagued by frequent price wars and large financial losses. The airlines were particularly hard hit by the recession of the early 1990s, and several nearly went bankrupt. U.S. airlines enjoyed soaring profits during the economic recovery of the mid-to late 1990s, only to suffer record losses during the 2001 recession and the aftermath of the terrorist attacks of September 11. These trends are partly due to fluctuations in demand, but are exacerbated by the industry cost structure and the nature of competition among carriers. Airline costs fall into three broad categories :

(a) Flight-sensitive costs, which vary with the number of flights the airline offers. These include the costs associated with crews, aircraft servicing, and fuel. Once the airline sets its schedule, these costs are fixed.

(b)Traffic-sensitive costs, which vary with the number of passengers. These include the costs associated with items such as ticketing agents and food. Airlines plan their expenditures on these items in anticipation of the level of traffic, but in the short run, these costs are also fixed.

(c) Fixed overhead costs, which include general and administrative expenses, advertising and marketing, and interest expenses.

Once an airline has set its schedule, flight-sensitive and overhead costs are fixed. Traffic-sensitive costs, which make up only a small percentage of total costs, are the only variable costs. This means that the airline is better off selling a seat at a low price-near marginal cost but well below average total cost-than not selling the seat at all. Thus, if airlines are operating well short of capacity, as they were in the early 1990s and early 2000s, they have tremendous incentives to reduce prices. Because marginal costs are so far below average costs, the airlines lost staggering sums during these price wars. The airlines covered their marginal costs, but failed to make appreciable contributions toward fixed costs. On the other hand, if airlines are at or near capacity, as they were during the economic expansion of the mid-to late 1990s, they can raise prices substantially above average costs without losing customers to competitors. In 2000, American Airlines recognized this close connection between capacity utilization, pricing, and profits. Anticipating the recession, American removed seats from all of its planes. Marketed as a quality enhancement, the strategy was also designed to prevent excess capacity and associated price reductions. Other carriers failed to follow. suit, however, and the recession set the industry back on its heels. Many other factors affect airline pricing. In some cases, such as when a carrier dominates a hub, an airline faces little competition on certain routes and may raise price accordingly. Even when two or three carriers compete on a route, they may be able to price at or near the monopoly level. Finally, although airlines seem to sell homogeneous products, there are a number of sources of differentiation among them. Business travellers prefer carriers that offer frequent service, which gives them flexibility to schedule meetings. Many travellers accumulate frequentflier miles, which encourages them to use the same carrier for all their flights.

Questions :

(i) Why is it so that many firms avoid price competition ?

(ii) Explain. When two or three carriers compete on the same route, they usually keep the price at or near monopoly level. Why ? Give reasons for your answer

7. What is SWOT Analysis. Do the SWOT Analysis of Indian Pharma Industry, by giving suitable examples

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