

# Flight #031120: Departing Ubiquity Destined For Segmentation?

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SWELBAR·ZHONG  
CONSULTANCY

# Introduction and Motivation

## What Did Mike Say?

- > Author Michelle Dean said, ***“Crisis forces commonality of purpose on one another.”***
- > Past shocks to the system typically impacted one link in the supply chain more than another. This Pandemic has impacted nearly all links in the supply chain with varying degrees of hurt.
- > Other than consolidation of players during the last decade, the period has lacked the volatility that other eras in the deregulated industry experienced.
- > Commercial airline service has been taken for granted for my 40 years in the business. Slight deviations as to how airline service is delivered needs a re-think.
- > **The new/future consumers of commercial airline service are likely to demand something different than the ubiquitous product the industry has delivered for decades.**
- > In my humble opinion, this point in time is less an inflection point for certain players within the commercial aviation ecosystem, and more its time for an industry **RESET**.

# In Memory of Michael E. Levine

Aviation recently lost an historic icon whose career led to the deregulated airline industry of today. On February 3, 2017, [Michael E. Levine](#) passed, R.I.P.

Almost 4 decades ago, the **economic regulation of airlines was the full-time occupation for the staff of the Civil Aeronautics Board, for departments within most airlines, lawyers and economists.** A brash young professor, holding appointments at CalTech and USC, used interdisciplinary approach to expand on his **1965 paper “Is Regulation Necessary? California Air Transportation and National Regulatory Policy”** 74 Yale Law Journal 1416 (1965).

When [Alfred Kahn was appointed Chairman of the CAB](#), he hired **Michael Levine to be the Board’s General Director, International and Domestic Aviation.** Under their leadership, academic credibility and energy, the Chairman and his General Director drove the CAB, Congress and the White House to the Airline Deregulation Act of 1978.

One may argue the merits of whether breaking the bonds of regulation is a good or bad idea; Levine cogently commented, **“The choice is between imperfect markets and imperfect regulation.”** Unlike many theoreticians, Prof. Levine was not intimidated by the challenge of applying his comments in the real world.



# Definitions

- > **Commodity Business:** One that **competes on price, not on the intrinsic traits of its product or service**—and it can mean trouble for your portfolio.
  - > If you can't figure out whether a business is a commodity-type business or not, pose the following question to yourself and a few friends: “Am I willing to pay more for Delta or Sun Country?”
- > **Ubiquitous:** In business, **something that is ubiquitous is widely adopted and can be found nearly everywhere.** Many types of technology and best practices are ubiquitous in business, meaning that all companies use them, and they are **not a source of competitive advantage.**
- > **Market Segmentation:** A marketing term that refers to **aggregating prospective buyers into groups or segments** with common needs and who respond similarly to a marketing action. Market segmentation **seeks to identify targeted groups of consumers to tailor products** and branding in a way that is attractive to the group.
- > **Product differentiation:** A marketing strategy **designed to distinguish a company's products or services from the competition.** Successful product differentiation involves identifying and communicating the unique qualities of a product or company while highlighting the distinct differences between that product or company and its competitors.

***Airline Competition in Deregulated  
Markets: Theory, Firm Strategy, and  
Public Policy***

Michael E. Levine

# Levine's Thinking On Sustainable Airline Models -- Applying That Thinking To Today's Providers

- > **Size confers advantages and disadvantages.** Networks can be an **effective way to combine flows and economize on marketing costs**, but they come with **vulnerabilities to labor, operational and political problems** (**THINK NETWORK CARRIERS, SOUTHWEST, ALASKA and JETBLUE**)
- > **LCCs can be successful**, but they face major challenges in growth. A large LCC tends to be more vulnerable to labor cost pressures and must also compromise its commitment to point-to-point service to grow past the limits that route density places on those airlines. (**THINK SOUTHWEST**)
- > In a sort of “Back to the Future” way, **passenger obsession with low vacation fares and willingness to sacrifice frequency and regularity of schedule means that leisure and resort markets can offer opportunities for specialist airlines to maintain low costs while confronting route density issues.** (**THINK ALLEGIANT, AVELO?**)
- > *No airline model can be successful that doesn't find a viable solution to the **route density challenge**.*
- > The fact that there are **few production economies of scale** means that size is not everything, indeed not even necessary. **An airline that solves the marketing and route density issue can have costs as low, and usually lower, than any mega-network.** (**FRONTIER, SPIRIT and SUN COUNTRY**)



# Levine on the Theory of Perfect Competition

- > Regulation stringently limited the use of pricing and product strategies
- > Much that has occurred in the airline industry since deregulation **cannot adequately be described using contestability models.**
- > **Product differentiation, network effects, and other apparent impediments to simple, cost-based pricing were not significant features of the short-haul intrastate** or long-haul charter markets which were the principal exceptions to Federal regulation (**Southwest and PSA**).
- > **The casualty rate among new entrants puzzled many analysts who favored deregulation and it generated concern about the nature of competition in deregulated airline markets. Holdover firms entered the deregulated era with a variety of handicaps** stemming from their previously-regulated status, including high labor costs, inefficient route systems, inefficient equipment mixes, and internal organizations poorly adapted to open competition.
- > Levine suggested that: “New Industrial Organization Theory”, can help to explain these deviations from contestability and the direction of the development of the U.S. domestic airline system since deregulation. The relationship between these factors, which limit contestability, and are responsible for the phenomenon.

# Levine: The 7 Factors Limiting Contestability

- 1.** The industry has been profoundly affected by the costs of developing and **communicating information about routes, schedules, seat availability, service features, and prices to consumers of air transportation.** These costs have contributed to the competitive significance of **computer reservations systems**, the practice of contractual vertical integration and **code sharing** between airlines, the **development of hubs**, and **airline consolidation.**
- 2.** Costs and **economies of scope.** In an industry in which firms **compete against one another in various combinations** in a very large number of city-pair markets, these economies create **advantages for large firms** willing to invest through operating losses in deterring smaller rivals from entry or price competition.



# Levine: The 7 Factors Limiting Contestability

- 3.** Costs are involved in the task of monitoring (generating information about and influencing) the behavior of parties to transactions whose interests differ from the parties on whose behalf they act. **These costs have contributed to the development and success of frequent flyer programs, complex fare structures, incentive payments to travel agents** by airlines to book business on that carrier, **the role of CRSs** in attaining competitive dominance, **the use by established airlines of airport facilities leases to raise rivals' costs through gate use agreements tied to ground handling contracts**, the relevance of firm size and balance sheet equity to "riding out" cyclical variations or predatory competitive tactics, and the **success of hub strategies**.
- 4.** There are **production indivisibilities** (incapable of being separated) **in providing information to travel agents and in providing competitively successful service to specific air transport city-pair markets**, or at certain times of the day or week, as **distinguished from production indivisibilities faced by an airline with respect to its total output**. **These indivisibilities have contributed to the importance** of CRSs, the dominance of a few CRS systems, the dominance of the hub strategy, the industry's current preoccupation with firm size for size's sake, the prevalence of mergers, and the complicated fare structures that have been characteristic of deregulated markets

# Levine: The 7 Factors Limiting Contestability

- 5.** Certain transaction and information costs influence access to capital in the face of uncertainty. Coupled with vast inequalities among firms in the amount of capital accumulated during the regulated era, these costs have contributed greatly to consolidation and to the drive for large size.
- 6.** Some airline behavior is designed to raise rivals' costs or handicap their ability to generate revenue. "Such behavior usually involves some out of pocket or opportunity cost to the firm employing the strategy, but sometimes coincides with a need to deal with the problem of "transaction-specific" assets." This behavior at least partially explains the industry preoccupation with tying up more terminal facilities and slots than necessary.
- 7.** Large holdover airlines have been able to survive and earn profits despite having higher aggregate unit costs than their new-entrant challengers. Thus, a number of developments in deregulated airline markets which seem inconsistent with perfect contestability.

# Levine: Deviations That Cannot Be Adequately Explained by Traditional Competition Models

> **From Levine's point of view, these surprising outcomes were identified as:**

1. A wave of mergers and consolidations;
2. A higher-than-expected degree of vertical integration in the industry, especially as demonstrated at the level of commuter airlines;
3. The dominance of hub and spoke systems;
4. The surprisingly complicated fare structure which has become characteristic of deregulated markets;
5. The importance of frequent flyer programs;
6. The significance of travel agents and the proliferation of incentive payments to them;
7. The role of Computer Reservation Systems (CRSs);
8. The emphasis in firm strategy on gaining and keeping control of airport slots and gates;
9. The apparent persistence, despite physically easy entry and exit, of predation; and, because of all these factors,
10. The high casualty rate among new entrants.

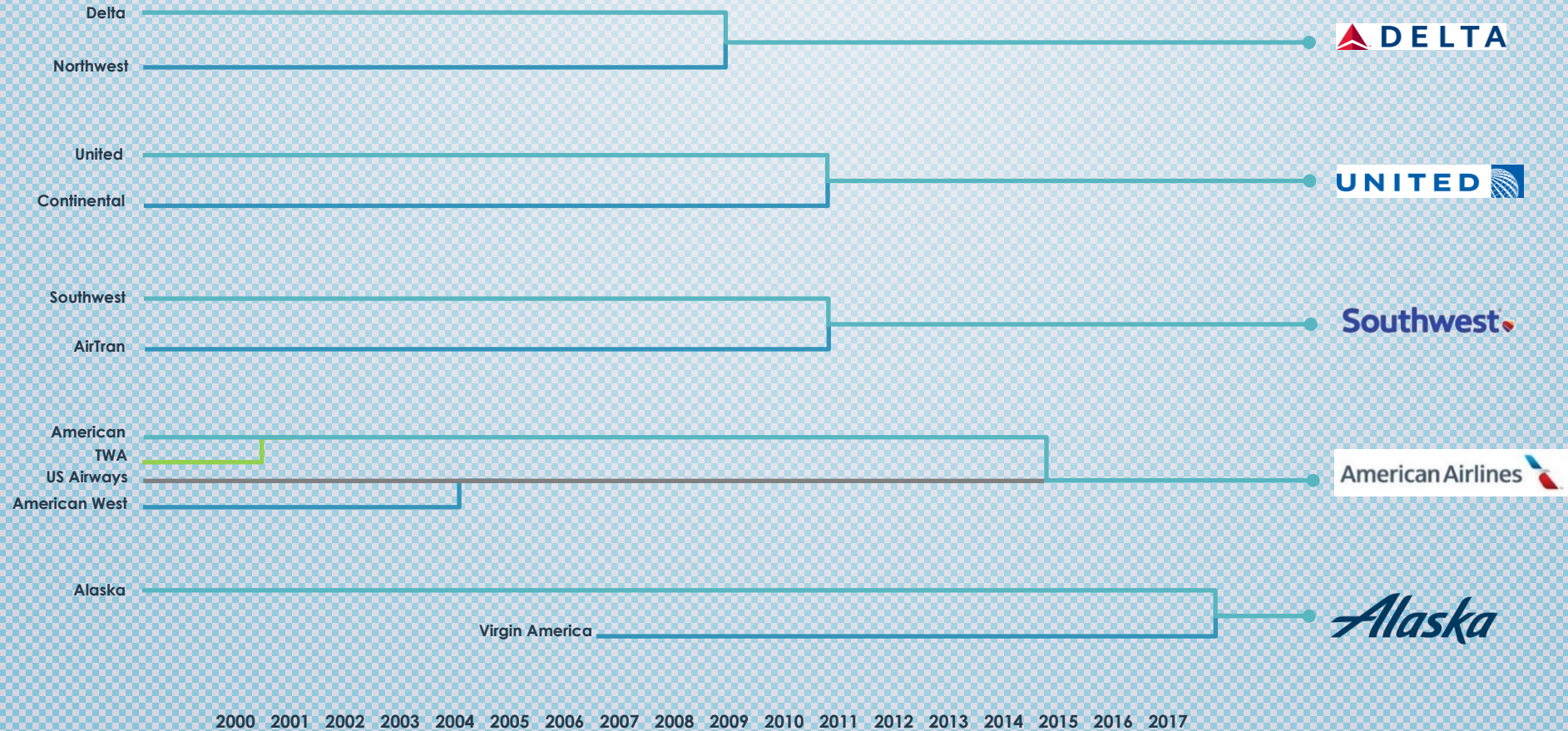


***Today's Thoughts on Levine's 10  
Deviations That Traditional Competition  
Models Did Not Explain In 1987***

# 1. Mergers

- > Most of this decade's mergers in the U.S. commercial aviation space have taken place in the regional airline sector. (Probably not many moves left)
  - > Consolidation in Europe is occurring more as a result bankruptcy than mergers. This should continue.
- > In a Democratic administration, might approval of mergers among the Big 4 be permitted? Among the Big 6?
  - > With 6 carriers, including the 2 new entrants, primarily focused on the leisure sector – just how many can the market support once this “post-COVID fatigue bubble” either dissipates or breaks?
- > There have been multiple transactions among technology firms and the related ecosystem along the supply chain serving the U.S. and global commercial aviation industry.
- > Activity among firms that lease aircraft to the commercial aviation space is taking place as it becomes clear that a recovery is imminent.
- > As airlines modernize fleets, there will be less demand for Maintenance, Repair and Overhaul providers – at least in the near term.
- > **However, might there not be some international opportunities if certain ownership laws were to be changed?**

# Consolidation: Combined Networks Enabled Some De-Hubbing and Concentrated Nearly 80% of the Domestic Market in the Hands of 4





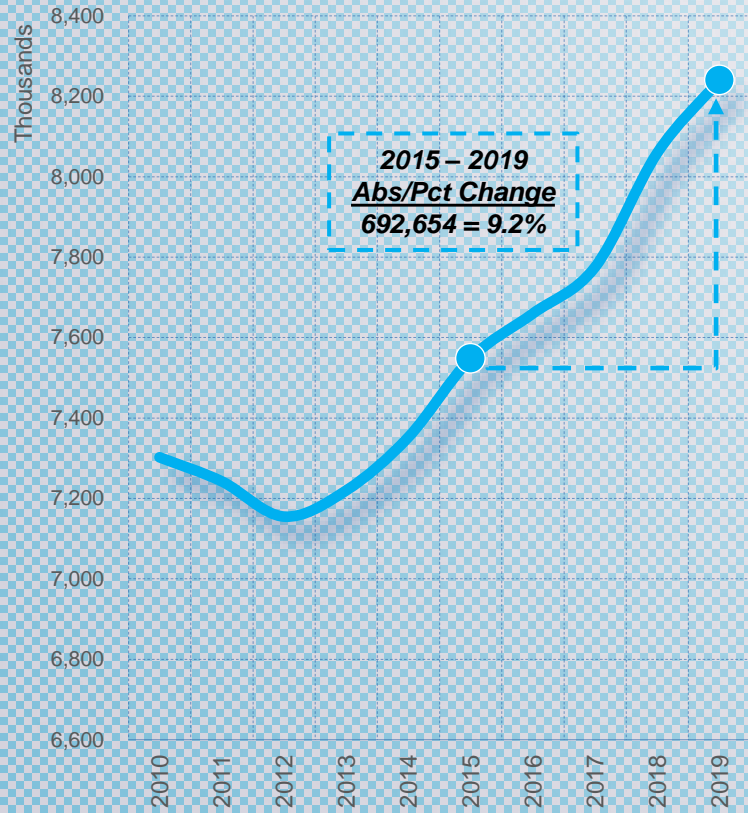
## 2. Vertical Integration/Regional

- > The ability to code share with commuter/regional airline partners created the marketing leverage needed to build hubs immediately after deregulation.
  - > Example: Before deregulation an airline might have served 5 city pairs on a point-to-point basis. But by creating a hub with those same 5 point-to-point markets served, 55 city pairs are created to sell to the consumer. Then if a carrier were to combine two hubs, each with 55 city pairs, 255 combinations are now available to sell to the consumer under one airline code.
- > Today's Potential/Hinderances:
  - > Agree to share codes with competing airlines like American and Alaska and American and jetBlue have combined to do.
  - > In today's regional sector, opportunities are limited for three big reasons: 1) aircraft technology; 2) mainline pilot scope clauses; and 3) related to scope clauses is the fact that any number of mainline pilots may have been separated from a company because of COVID – the focus will be on their return first.
    - > Small community air service is all but certain to become a topic again in Washington.
- > All transactions will require USG approval. American/jetBlue/Alaska managed to get their approval with an administration packing its boxes and having one foot out of the door.
  - > One will have to weigh whether a looser relationship accomplishes a desired commercial outcome versus a merger where both revenue and cost synergies can be achieved.

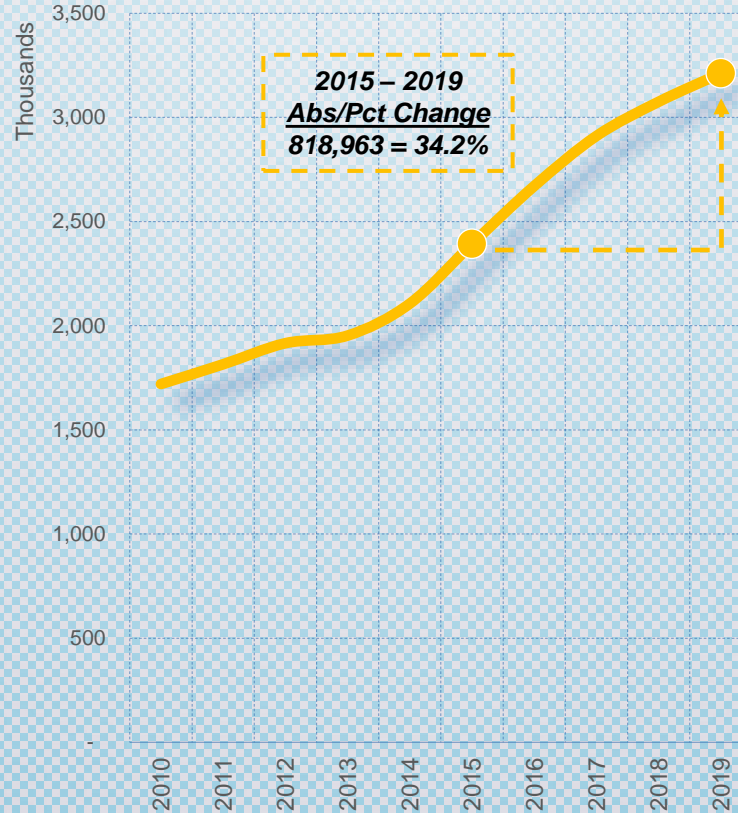
# Outbound Block Hour Trends

- Network Carriers\* Only

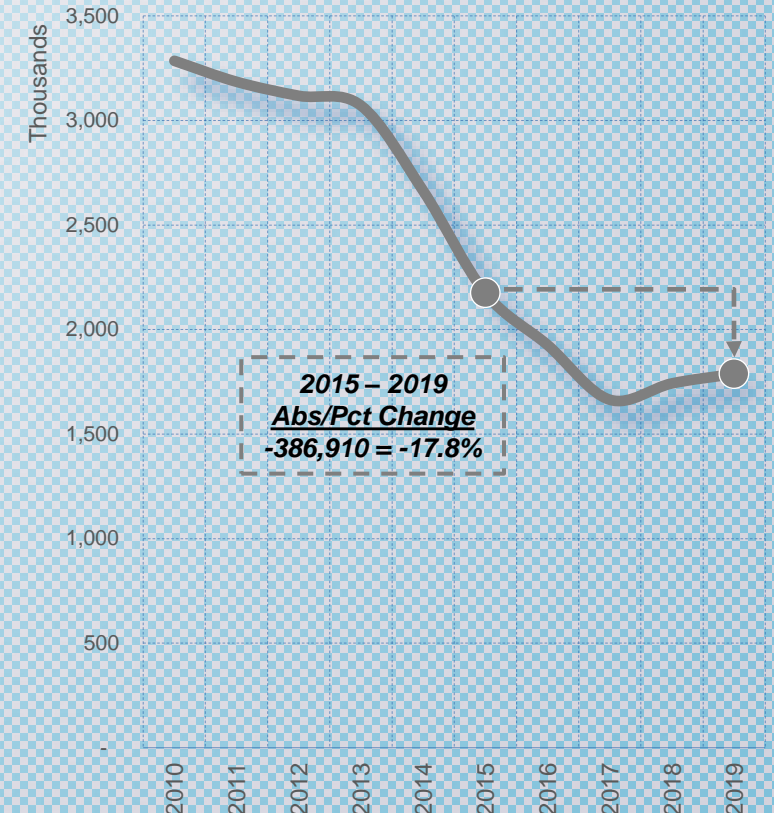
### Mainline Jet



### Large Regional Jet



### Small Regional Jet

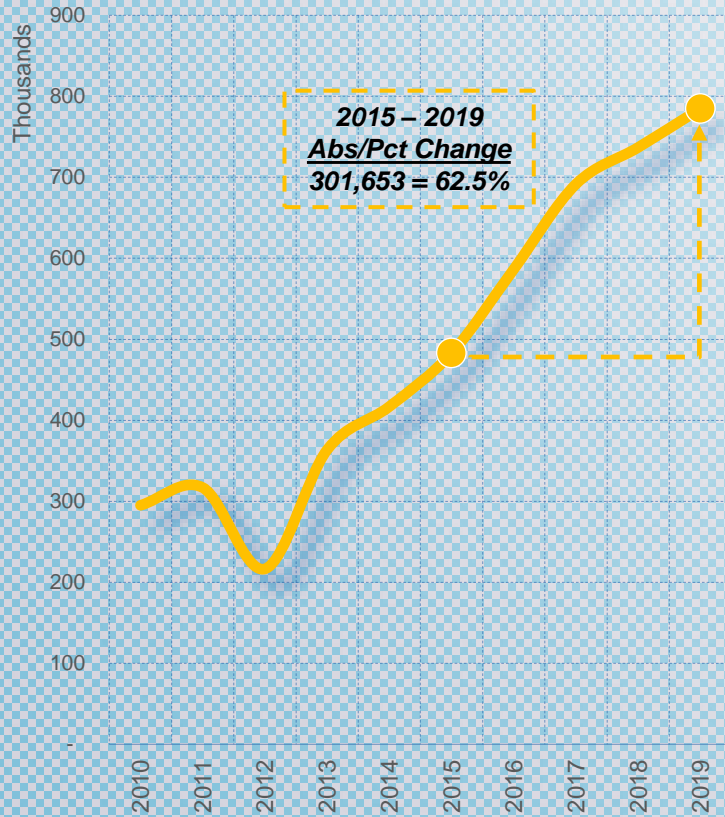


Source: US DOT, T-100 database.

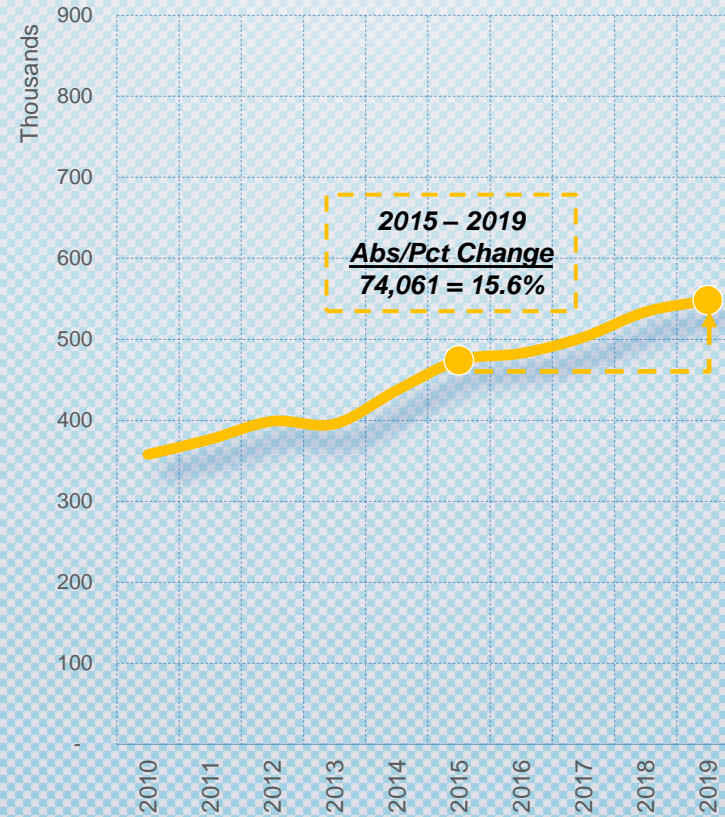
# The Slope of the Lines Explains Each Carrier's Scope Restrictions at the End of 2019; Imagine Today?

– DEPARTURES BY LAREG RJ

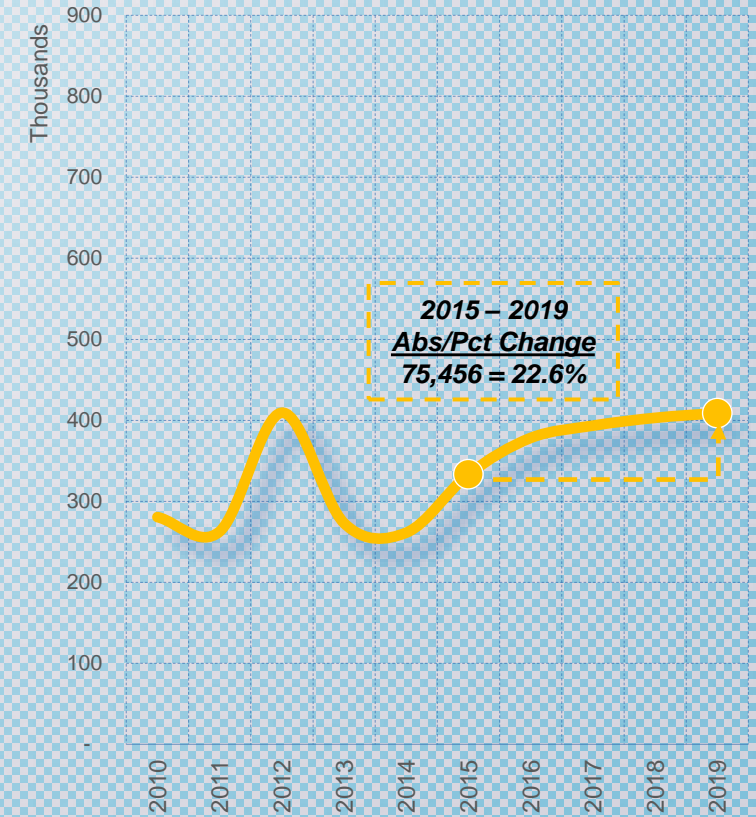
## AMERICAN



## DELTA



## UNITED



Source: US DOT, T-100 database.



# 3. Dominance of Hub and Spoke

- > Dominance described airline hubs for many years as the industry grew into its current configuration.
- > Airports/Cities that have long been relegated as spokes to multiple hubs around the country have developed into city pairs that can support nonstop service – a product preferred to a connecting product.
- > Among the Medium and Small hub airports, as defined by the FAA, a forecast of domestic traffic based in the economic and demographic attributes of a metro area very clearly points to those markets that are winning new nonstop service today. What cannot be accounted for is the fact either has a leisure orientation or not. This factor has been significant, at least in the short-term, in a carrier's choosing where to add service.
  - > When the absolute numbers of local market passengers that are forced to connect to get to their desired destination, the list of markets ripe for new entry or adding service is fortified.
- > As the domestic industry recovers from the demand shock, the return of international service will prove critical to the re-building of hubs and gateways.
- > Many factors suggest that the number of pre-COVID hubs may not be necessary as the industry recovers/resets.

# Pre-COVID U.S. Airline Hubs

A Smaller Domestic Network Industry = Less Connectivity At Certain Hubs



***"The efficacy of a fortress is plainly composed of two different elements, the passive and the active. By the first it shelters the place, and all that it contains [think hub]; by the other it possesses a certain influence over the adjacent country, even beyond the range of its guns [think spoke]".***

***On War*** by von Clausewitz



# Pre-COVID Forecast Based On Economics and Demographics Only

Post-COVID Airline Decisions Will Have A Profound Impact On The Winners and Losers

2018			
Large	Medium	Small	Nonhub
LAX	AUS	PVD	ILM
DEN	BNA	MEM	BIL
LAS	SJC	CHS	TTN
ORD	MSY	LGB	EYW
MCO	OAK	RNO	FNT
ATL	DAL	OKC	MSO
SFO	STL	RIC	FAR
SEA	RDU	BOI	RDM
BOS	SMF	GEG	BLI
PHX	MCI	ORF	BTR
DFW	SNA	SDF	ABE
LGA	HOU	TUS	SBA
EWR	RSW	LIH	DAB
FLL	CLE	KOA	PSC
JFK	SAT	SFB	TLH
SAN	IND	ELP	FWA
MSP	PIT	GRR	AMA
DCA	CVG	ALB	JAC
PHL	CMH	TUL	JNU
DTW	MKE	BHM	CHO

2028			
Large	Medium	Small	Nonhub
LAX	AUS	PVD	ILM
DEN	BNA	CHS	BIL
LAS	SJC	MEM	RDM
MCO	MSY	RNO	FAR
ORD	OAK	LGB	TTN
ATL	DAL	OKC	EYW
SFO	RDU	BOI	MSO
SEA	STL	RIC	FNT
BOS	SMF	GEG	BLI
PHX	SNA	TUS	BTR
DFW	MCI	ORF	ABE
LGA	HOU	SDF	PSC
EWR	RSW	LIH	SBA
FLL	SAT	KOA	DAB
SAN	IND	ELP	MFE
JFK	CLE	SFB	TLH
MSP	PIT	GRR	AMA
DCA	CVG	ALB	JAC
PHL	CMH	TUL	FWA
TPA	MKE	BHM	JNU

Percent Change			
Large	Medium	Small	Nonhub
PHX	AUS	XNA	MFE
IAH	SAT	BZN	SGU
CLT	RDU	FSD	HRL
DFW	ONT	BOI	PVU
LAS	DAL	AZA	LRD
PDX	HOU	PSP	GCN
DEN	BNA	MAF	BRO
ATL	JAX	ELP	RDM
MCO	CMH	CHS	GCC
IAD	SNA	LIT	PGA
SEA	SJC	RNO	STC
MIA	ABQ	FAT	DRO
DCA	SMF	BTV	ISN
MSP	SJU	LBB	HOT
SAN	ANC	DSM	OGD
FLL	MCI	SRQ	FAR
TPA	OMA	SFB	BIS
BWI	OGG	VPS	PLN
SLC	RSW	RIC	RST
HNL	PBI	MDT	SOW



# Hub and Spoke OR Spoke and Hub?

Some Markets Are Just Ready Made: Not All Will Be Winners -- But...

- > Combining a market's economic and demographic underpinnings with the absolute number of local passengers that were forced to connect pre-COVID, in effect create a ready-made list of airports to enter whether an incumbent or a new entrant.
- > All but a few of the markets identified have received new nonstop services over the past years.
  - > "Tech Focus Cities" in Nashville, San Antonio, Kansas City, Boise and Indianapolis have all been winners.
  - > "Emerging Tech Focus Cities" like Grand Rapids, Madison, Greenville, SC, and Upstate New York have seen service grow.
  - > Savannah, the Florida Panhandle and others have emerged as emerging leisure regions.
- > More to come as Fayetteville, AR and Huntsville, AL are discovered. There will be more.

1

Austin, TX	San Jose, CA
Nashville, TN	Pittsburgh, PA
New Orleans, LA	Cleveland, OH
Raleigh/Durham, NC	Fort Myers, FL
San Antonio, TX	Columbus, OH
Sacramento, CA	Jacksonville, FL
Kansas City, MO	Hartford, CT
Santa Ana, CA	Milwaukee, WI
Indianapolis, IN	Cincinnati, OH
St. Louis, MO	Albuquerque, NM

2

Houston Hobby, TX	Richmond, VA
West Palm Beach, FL	Anchorage, AK
Omaha, NE	Buffalo, NY
Oakland, CA	Kahului, HI
Ontario, CA	Tucson, AZ
Oklahoma City, OK	Reno, NV
Memphis, TN	Spokane, WA
Charleston, SC	Providence, RI
Norfolk, VA	Boise, ID
Dallas Love Field, TX	Louisville, KY

3

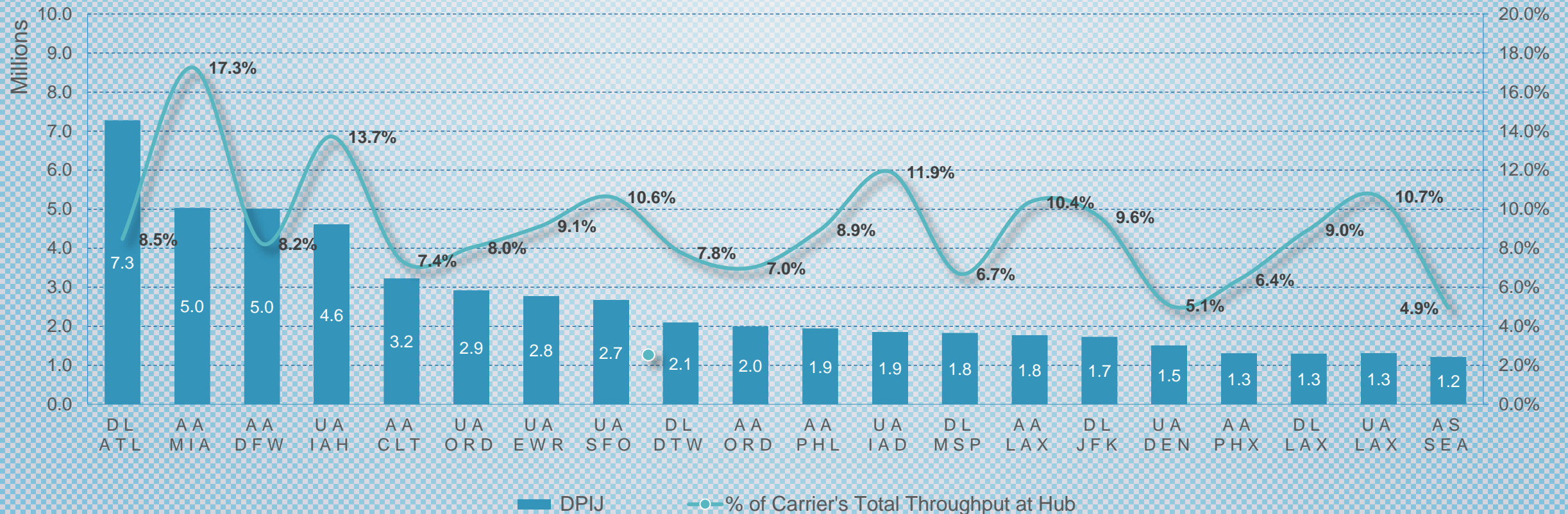
Grand Rapids, MI	Savannah, GA
El Paso, TX	Kona, HI
Burbank, CA	Myrtle Beach, SC
Birmingham, AL	Little Rock, AR
Tulsa, OK	Pensacola, FL
Albany, NY	Madison, WI
Des Moines, IA	Portland, ME
Greer, SC	Knoxville, TN
Lihue, HI	Manchester, NH
Rochester, NY	Greensboro, NC

4

Palm Springs, CA	Huntsville, AL
Colorado Springs, CO	Lexington, KY
Wichita, KS	Midland/Odessa, TX
Dayton, OH	Cedar Rapids, IA
Bozeman, MT	Eugene, OR
Fresno, CA	Panama City, FL
Fayetteville, AR	Sioux Falls, SD
Sarasota, FL	Asheville, NC
Burlington, VT	Chattanooga, TN
Fort Walton Beach, FL	Wilmington, NC
Harrisburg, PA	Springfield, MO
Columbia, SC	Medford, OR

# The Importance Of International Traffic To Domestic Hubs Is Making It Hard To Rebuild Domestic Networks

TOP 20 U.S. CARRIER/GATEWAY RANKED BY 2019 DPIJ\*



\*Domestic Portion Of International Journey.

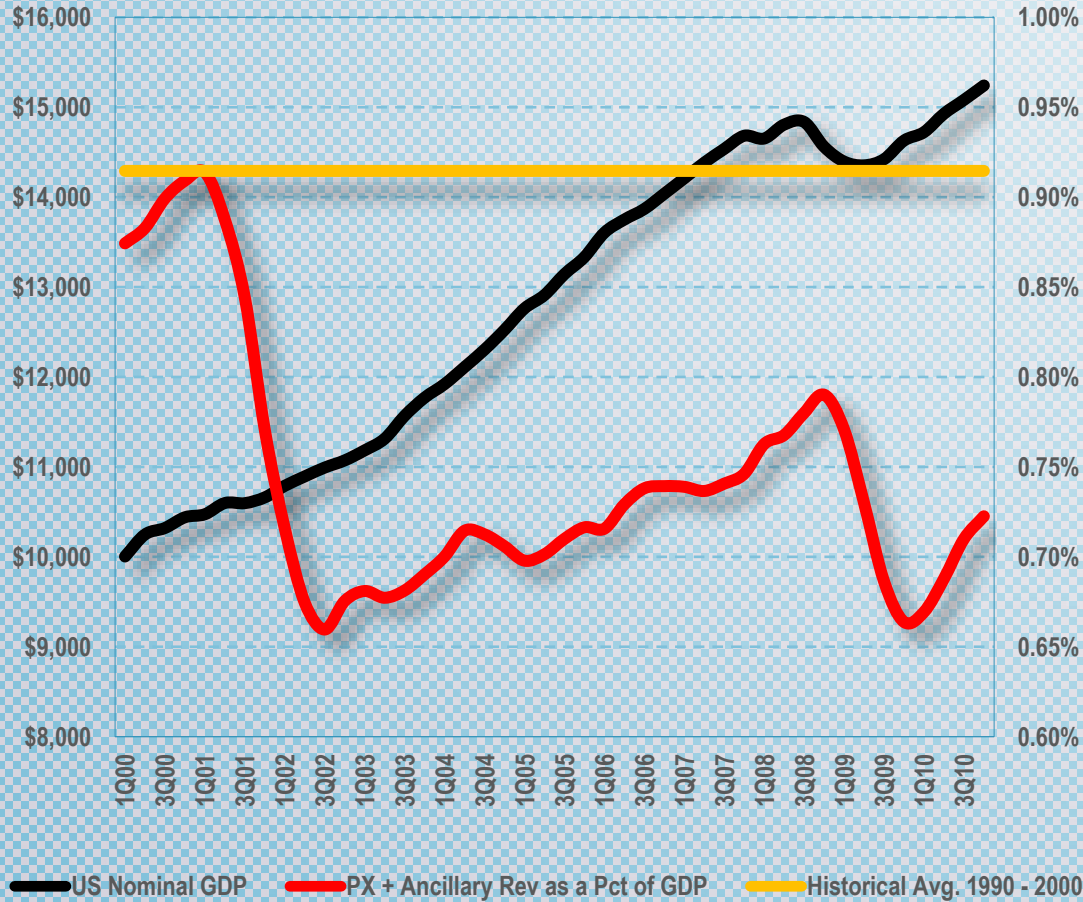


# 4. Complicated Fare Structure

- > Levine makes the point many times over that the deregulators did not see a fare structure become so complex when it was the intrastate, simple structure that was believed to be the model for the industry at the time.
- > Despite the complex fare structures then, and now, the domestic industry's passenger revenue and ancillary fees as a percent of GDP have consistently resulted in less actual revenue than expected revenue based on the historic relationship. The exception being during the years where the industry employed a "Capacity Discipline" strategy.
- > While not shown, the damage to industry revenue resulting from the COVID shock far surpassed 9/11.
- > This industry has just enjoyed a very stable decade in terms of competition and earnings. I believe that is about to change – complex fare structure or not every carrier best have their cost structures under control which many do not.

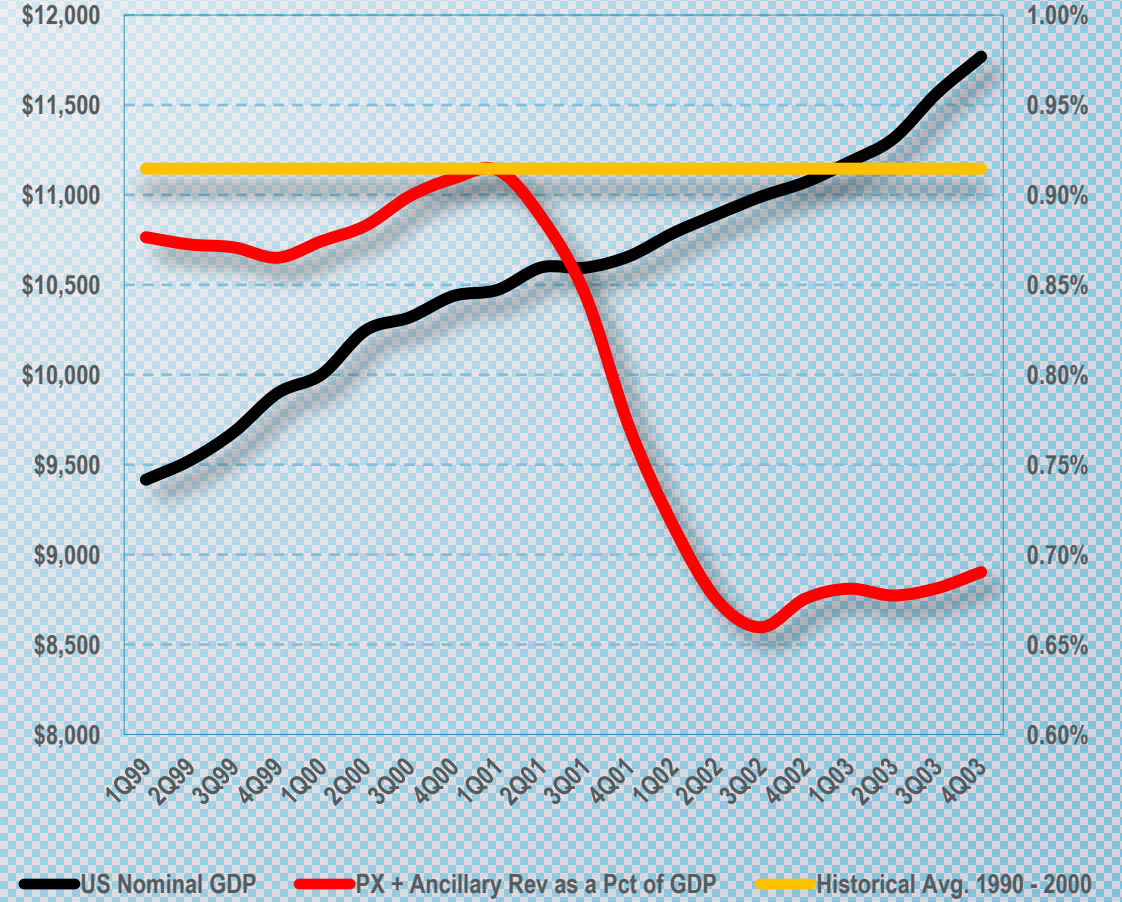
# The Lost Decade

Based on the Historical Relationship to GDP



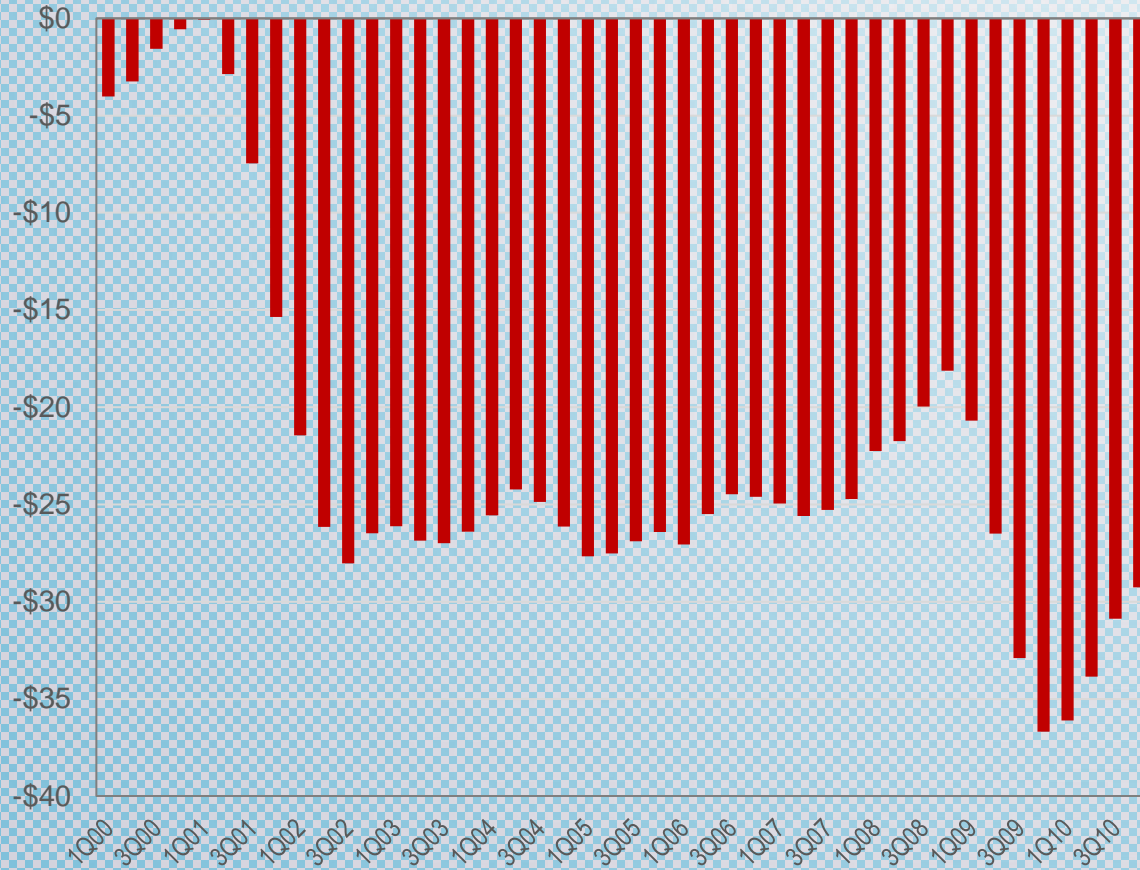
# The 9/11 Demand Shock

Based on the Historical Relationship to GDP



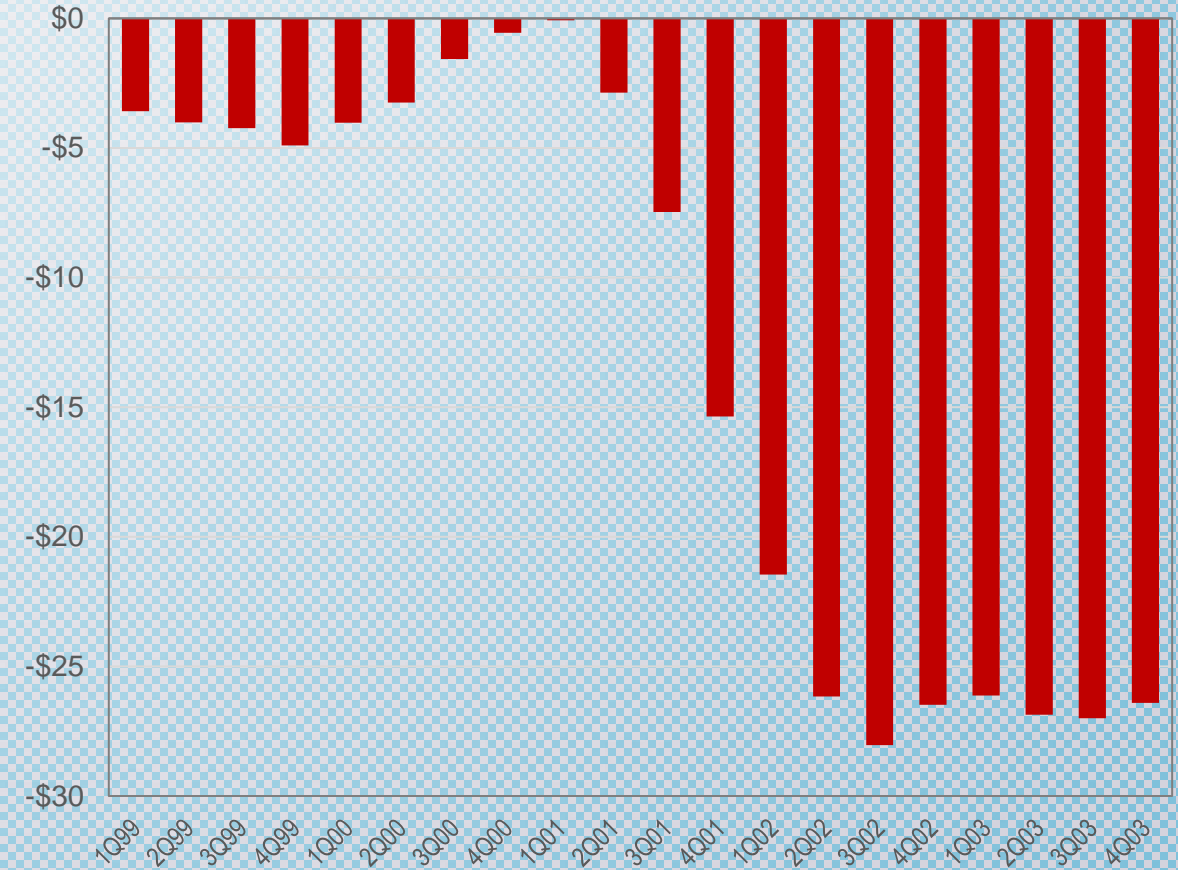
# The Lost Decade

Based on the Historical Relationship to GDP  
2000 – 2010 v. 1990 - 2000



# The 9/11 Demand Shock

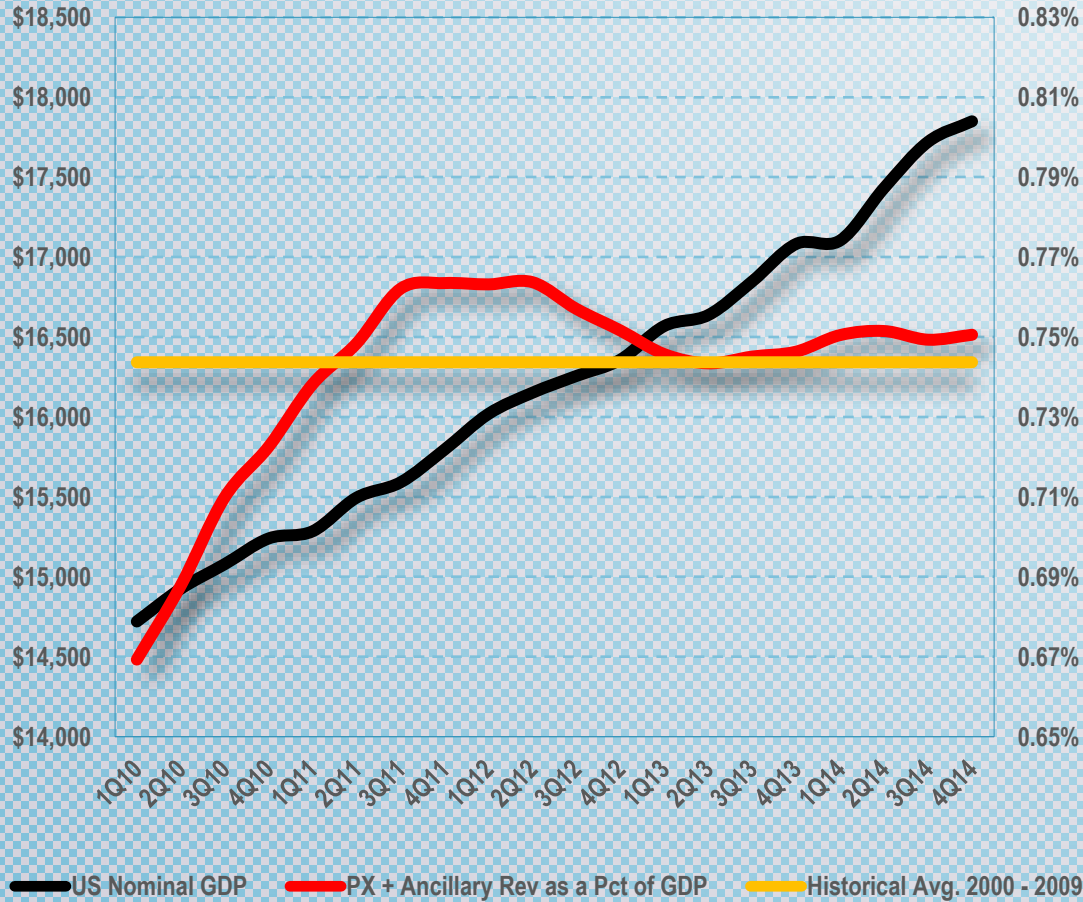
Based on the Historical Relationship to GDP  
1999 – 2003 v. 1990 - 2000





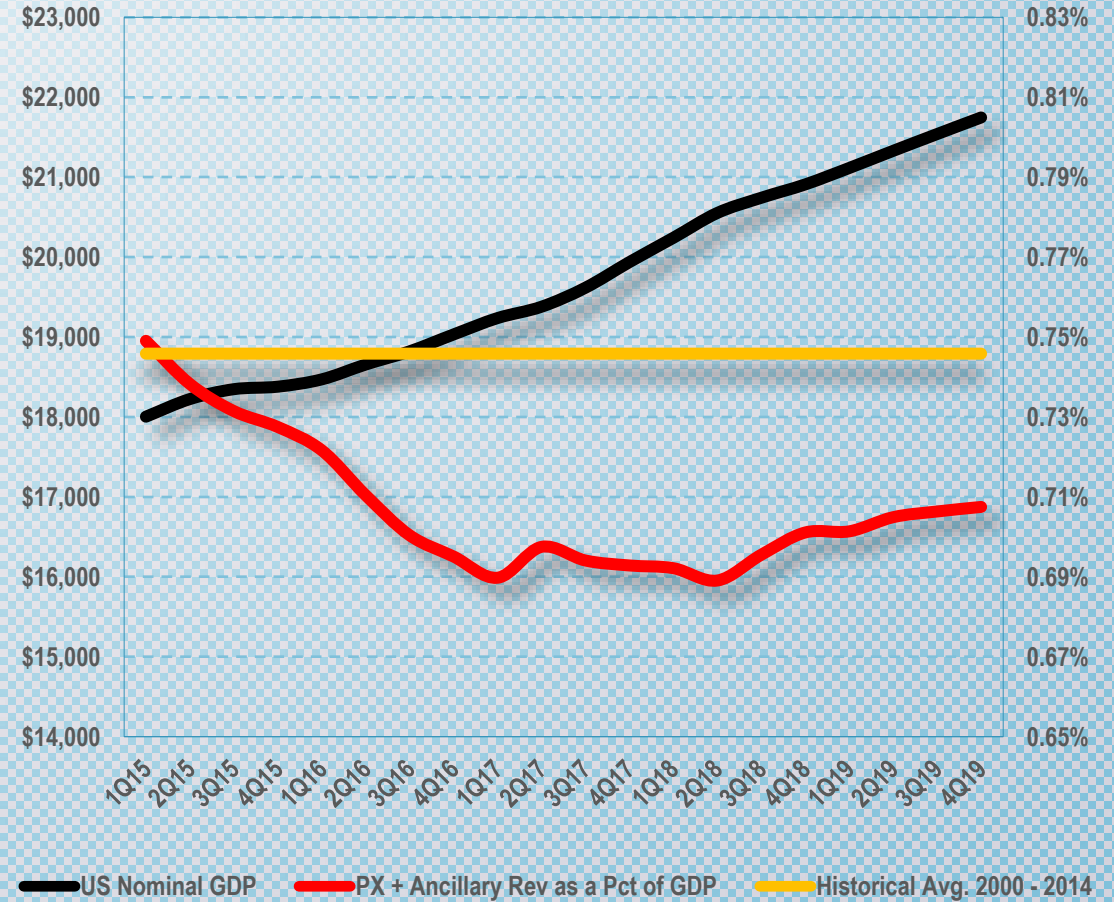
# The "Capacity Discipline" Era

Based on the Historical Relationship to GDP



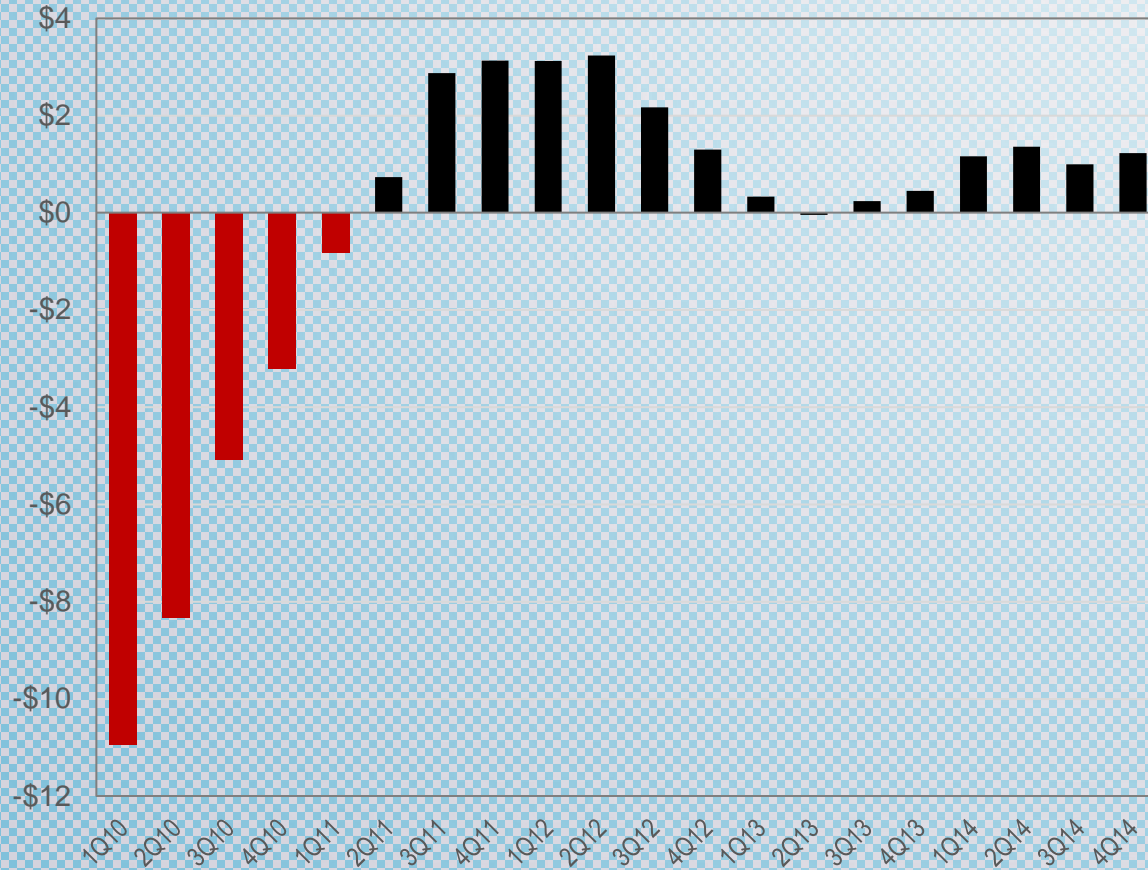
# The "Capacity Regeneration" Era

Based on the Historical Relationship to GDP



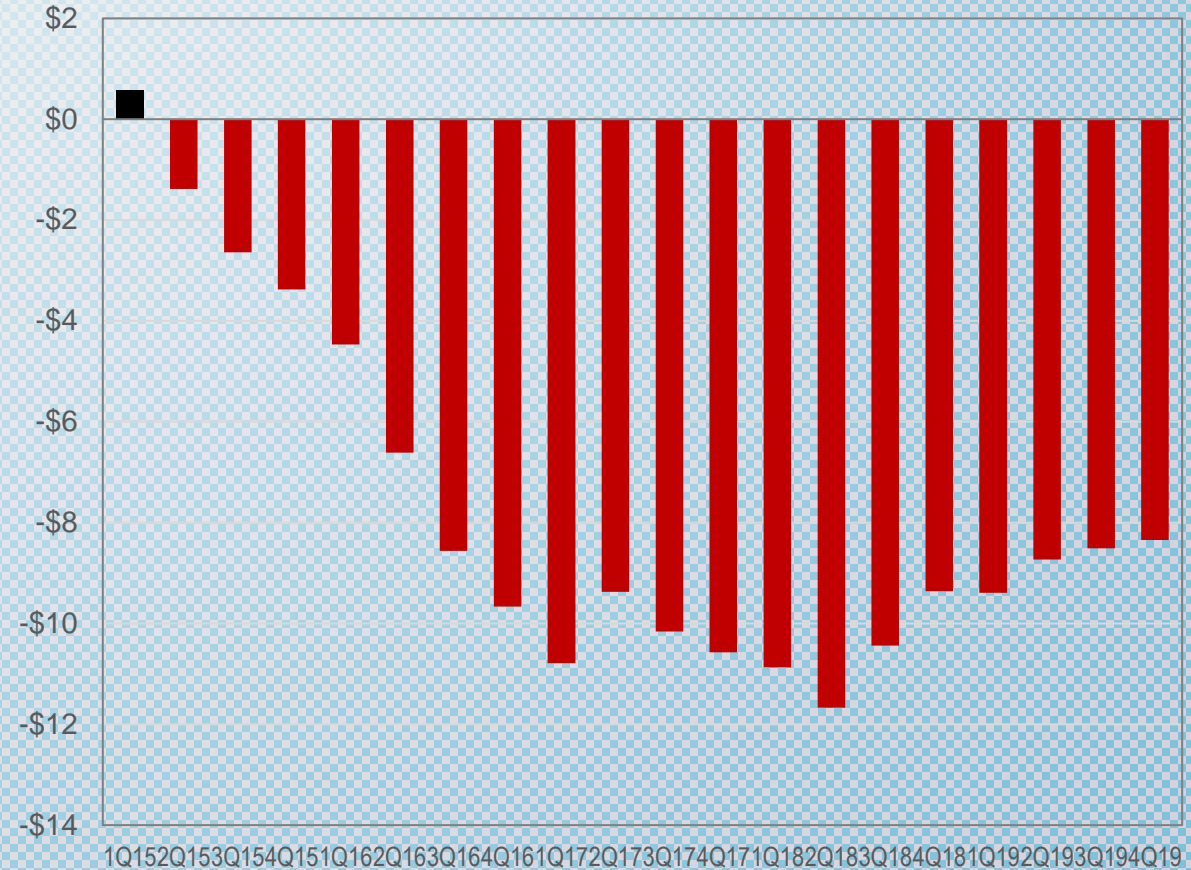
# The "Capacity Discipline" Era

Based on the Historical Relationship to GDP  
2010 – 2014 v. 2000 - 2009



# The "Capacity Regeneration" Era

Based on the Historical Relationship to GDP  
2015 – 2019 v. 2000 - 2014

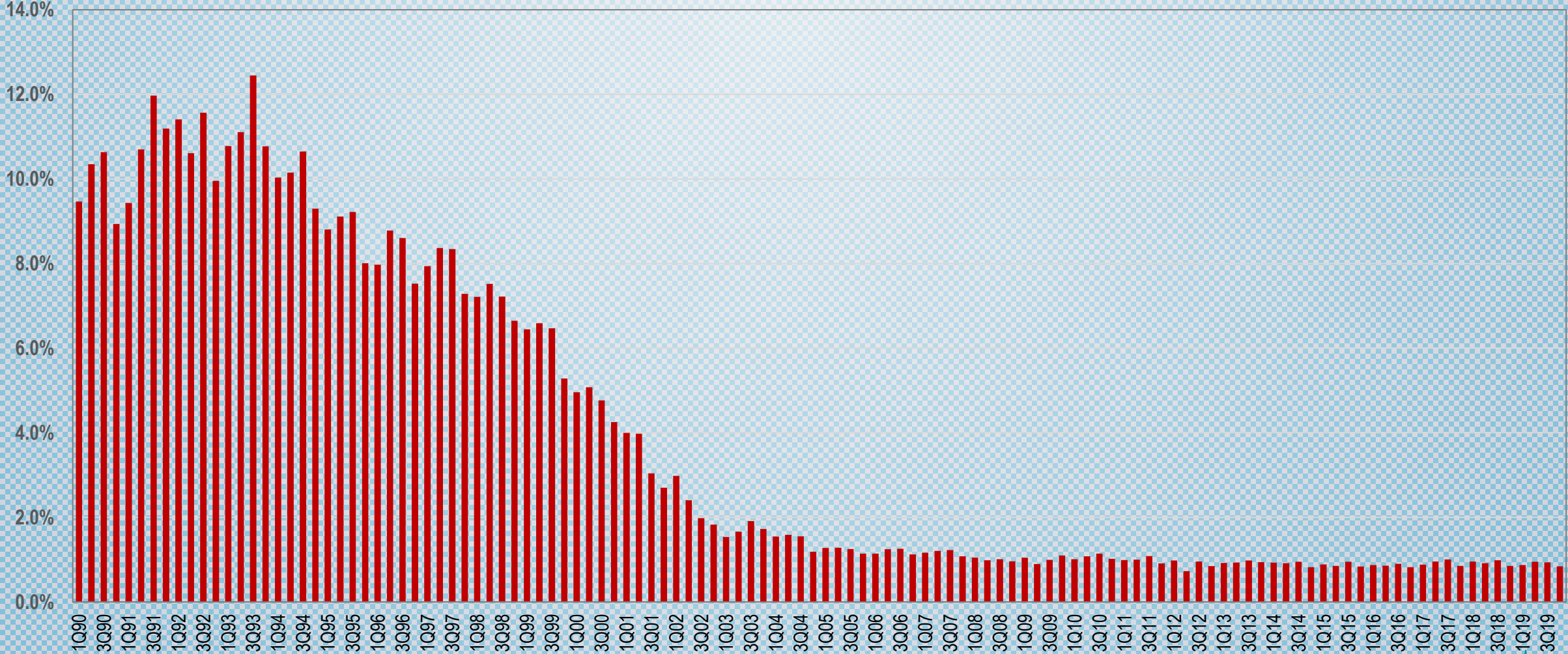


# 5. Frequent Flyer Programs; 6. Travel Agents; and 7. Computer Reservation Systems

- > I am being very liberal by combining 3 of Levine's points of significance impacting contestability at the time of his writing.
  - > There should be little question that Frequent Flyer Programs have had a profound impact in how commercial air travel consumers have chosen/choose an airline. The fact is that these plans have become so valuable to not only the airline but other merchants as well, that the plans have been used as collateral to raise cash in the face of the COVID crisis.
  - > Travel agents played a significant role in selling airline tickets between 1978 – 1993. There was a significant associated with a middleman and as technology morphed, the travel agent and the expense could be all but eliminated. The digital world was born.
- > **In thinking about this presentation, there are now consumers that have know little but mobile access. The Generation Ys and Zs have a proclivity for travel. The industry we know has largely been built around the Baby Boomers and the Gen Xers. These new consumers are quite different.**
  - > **This IS a great time to consider entering the market with a technology angle.**
  - > **Any wonder why traditional airlines just might be paying more attention to all things about diversity and the climate?**



# Commissions Paid to Third Parties as a Percent of Passenger Revenue



# The Generations Are Different Consumers

<b>B</b> <b>Baby Boomers</b>
Born: 1946 - 1964.
71.6 million.
Biggest consumers of traditional media but over 90% have a Facebook account.
Ensuring retirement, a major concern.
Most disposable income. Less influenced by peers.
Average Annual Travel Spend -- Airlines: \$1,800 -- Hotels: \$1,670 -- Rental Cars: \$549

<b>X</b> <b>Generation X</b>
Born: 1965 – 1980.
65.2 million.
Still watch TV and other traditional media. Digitally savvy. Heavy Facebook users.
Rising a family, paying off student debt and taking care of aging parents a strain on resources.
Average Annual Travel Spend -- Airlines: \$1,859 -- Hotels: \$1,726 -- Rental Cars: \$535

<b>Y</b> <b>Generation Y/Millennials</b>
Born: 1981 – 1996.
72.1 million.
95% still watch TV but lean to Netflix. Very comfortable with mobile, but nearly 1/3 still use computer for purchases. Typically have multiple social media accounts.
Massive student debt delaying major purchases.
Highest spending generation in 2020. Expected inheritance potentially make the Millennials the wealthiest generation in history.
Average Annual Travel Spend -- Airlines: \$1,637 -- Hotels: \$1,563 -- Rental Cars: \$504

<b>Z</b> <b>Generation Z</b>
Born: 1997 -
68 million.
Have know little but mobile access.
More fiscally conservative after watching struggles of Y. Much more fiscally conservative.
Projected to hit \$33T in income by 2030. Most influenced by known and online peers. Could pass the Millennials in 2031.
Average Annual Travel Spend -- Airlines: \$2,068 -- Hotels: \$1,842 -- Rental Cars: \$561



# 8. Gates/Slots

- > It is simply hard to dance around this one.
- > The last major merger, Alaska – Virgin America, was a real estate play.
  - > The last round of consolidation did not produce any real product differentiation.
  - > The last round of consolidation did not produce any real market segmentation.
    - > Some may argue that increasing the number of onboard seating products did to some extent.
    - > But it was still about a base PRICE.
  - > Based solely on our analysis of Medium Hub markets, there were significant numbers of city pairs that had traffic and revenue to support a LAX service, for example, if only there was a gate available. Simply, in many airports, “The Inn was Full” and not open for new business.
- > Thinking that this topic along with small community air service just might be discussed in Washington yet again.

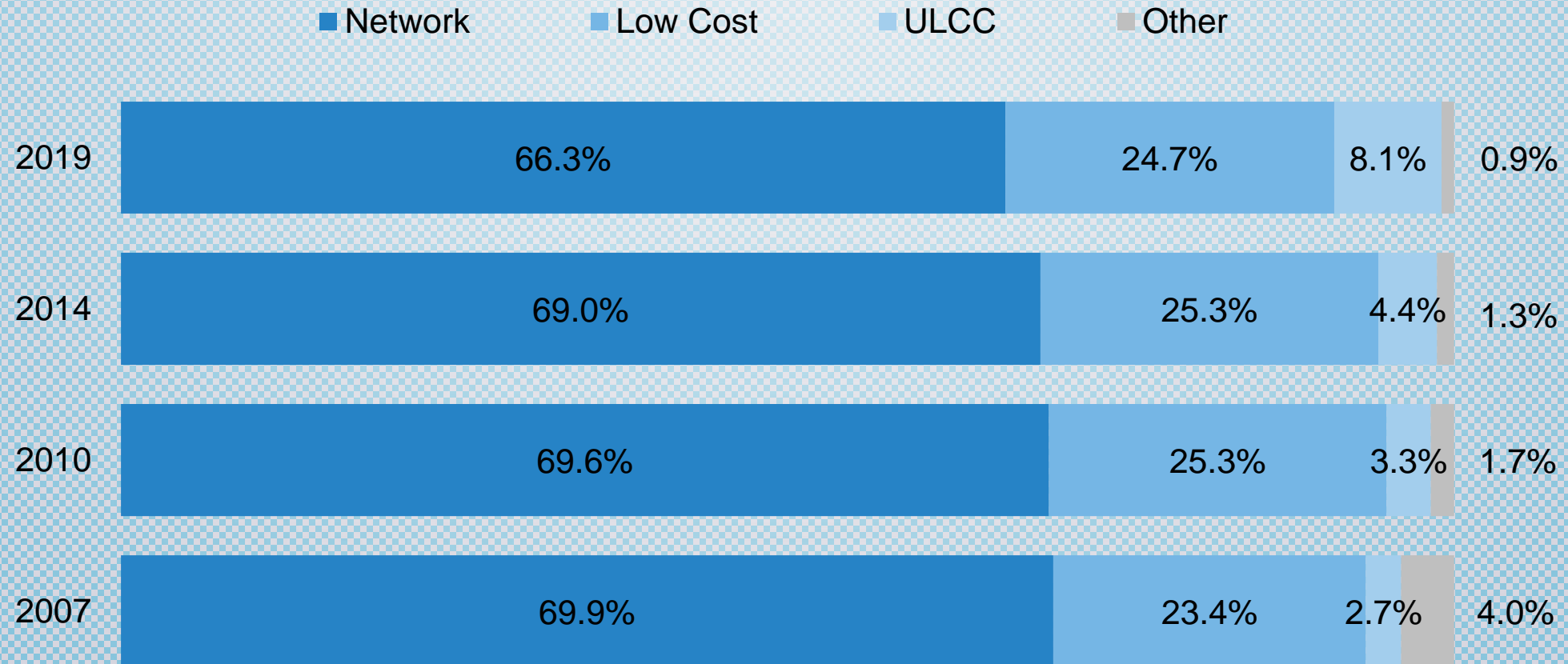


# 9. Predation

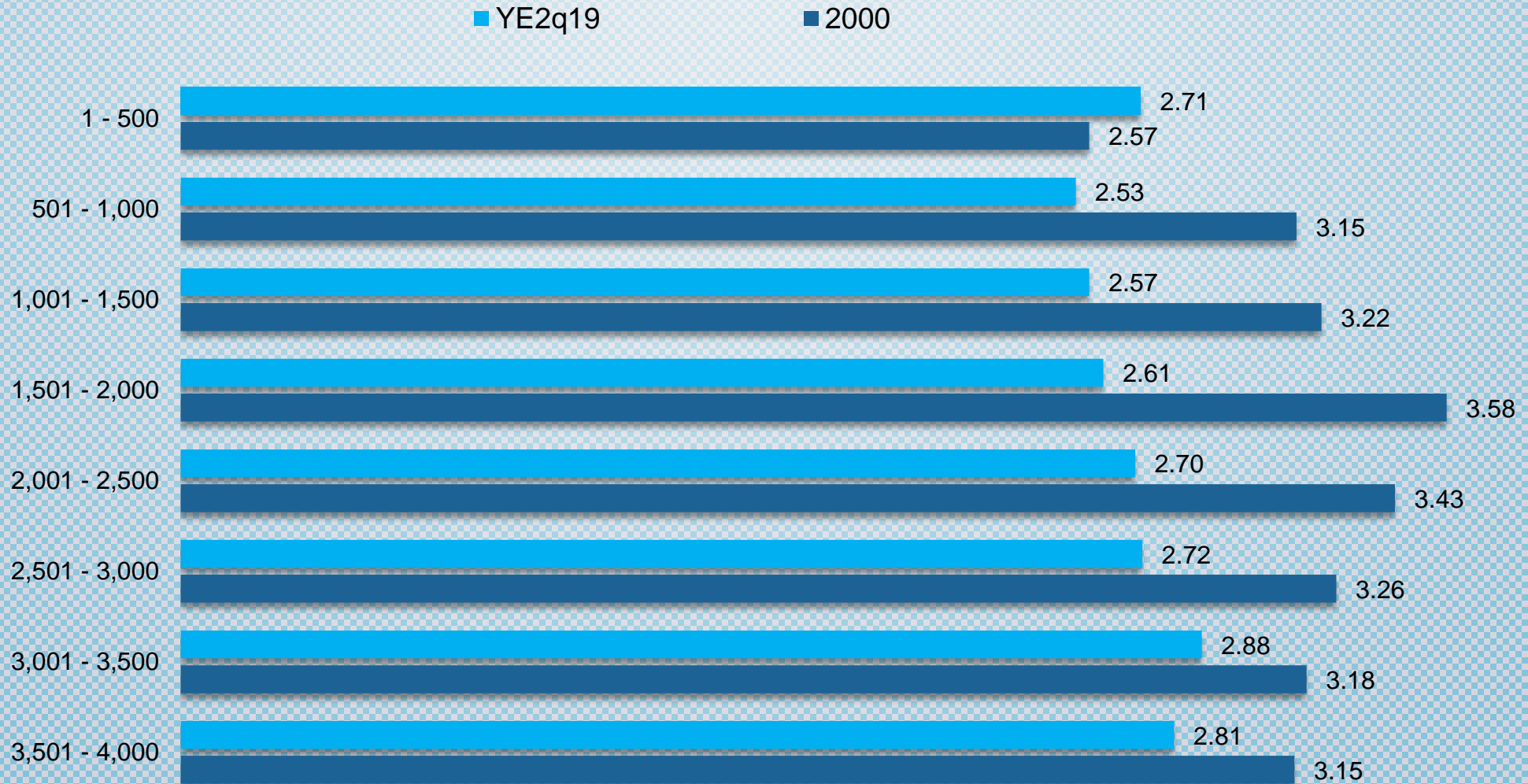
- > For those of us much older than many listening today, predation in a city pair occurs when a stronger, bigger competitor adds capacity and/or aggressive pricing against a weaker competitor that might have entered a market and is deemed as unwanted or maybe a nuisance.
- > As this is a much more mature industry today, the larger city pair markets were mostly served nonstop by multiple carriers. There are few, if any, monopoly routes today that could support a nonstop service and are unserved.
- > In fact, this is but one of the reasons why the U.S. domestic commercial air service market is about to enter a competitive phase. One new entrant said the time is right for entry because profit margins for the industry are too high – meaning fares are too high. Moreover, if margins are high, then fares must be higher than perceived because the cost structures of the incumbents are high. A competitive advantage is available to the new entrant.

# U.S. Domestic Carrier Capacity Share Changes

## LCCs and ULCCs Accounted for 32.7% at Year End 2019

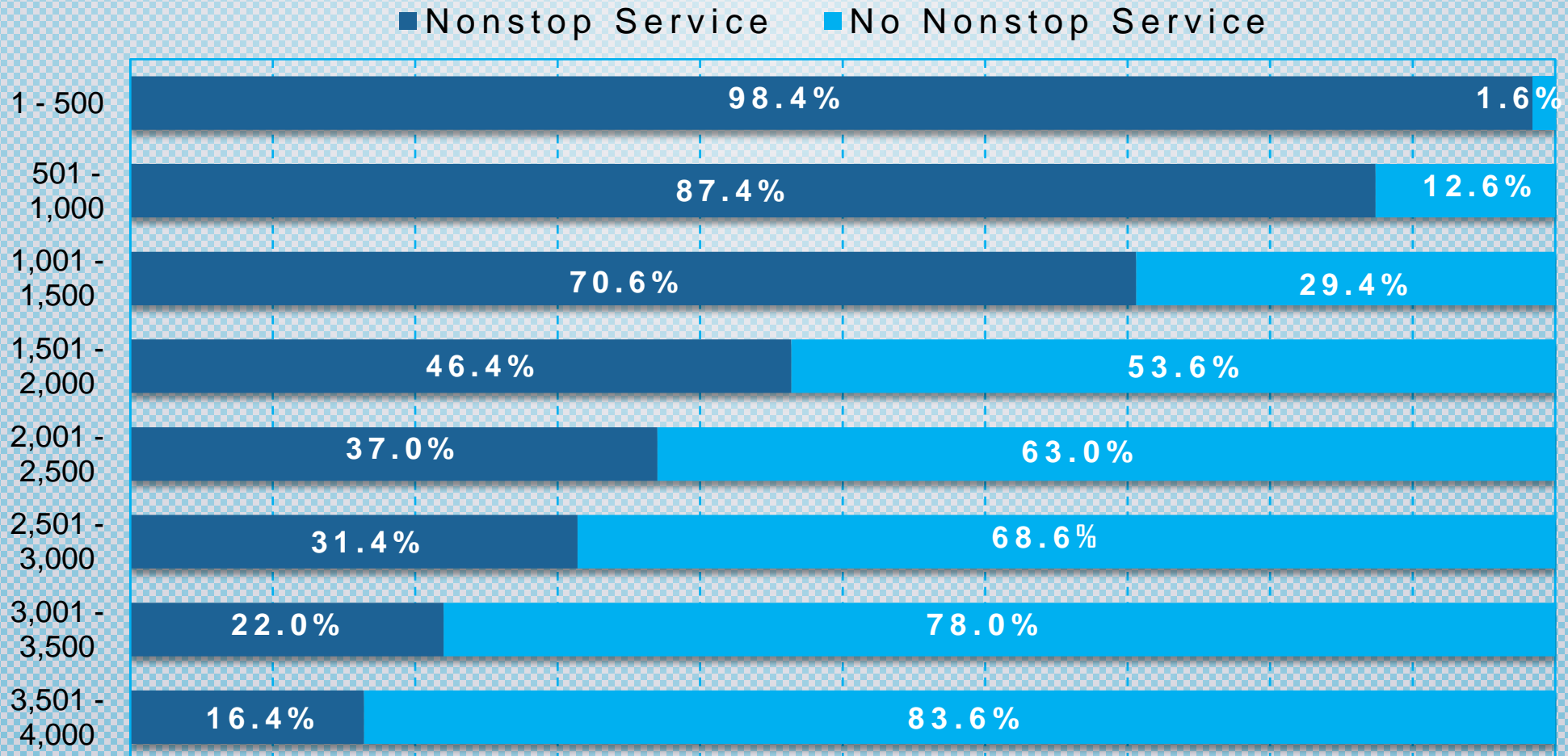


# Average Number of Competitors In The Top 4,000 Domestic O&D Airport Pairs, YE2q19 vs. 2000

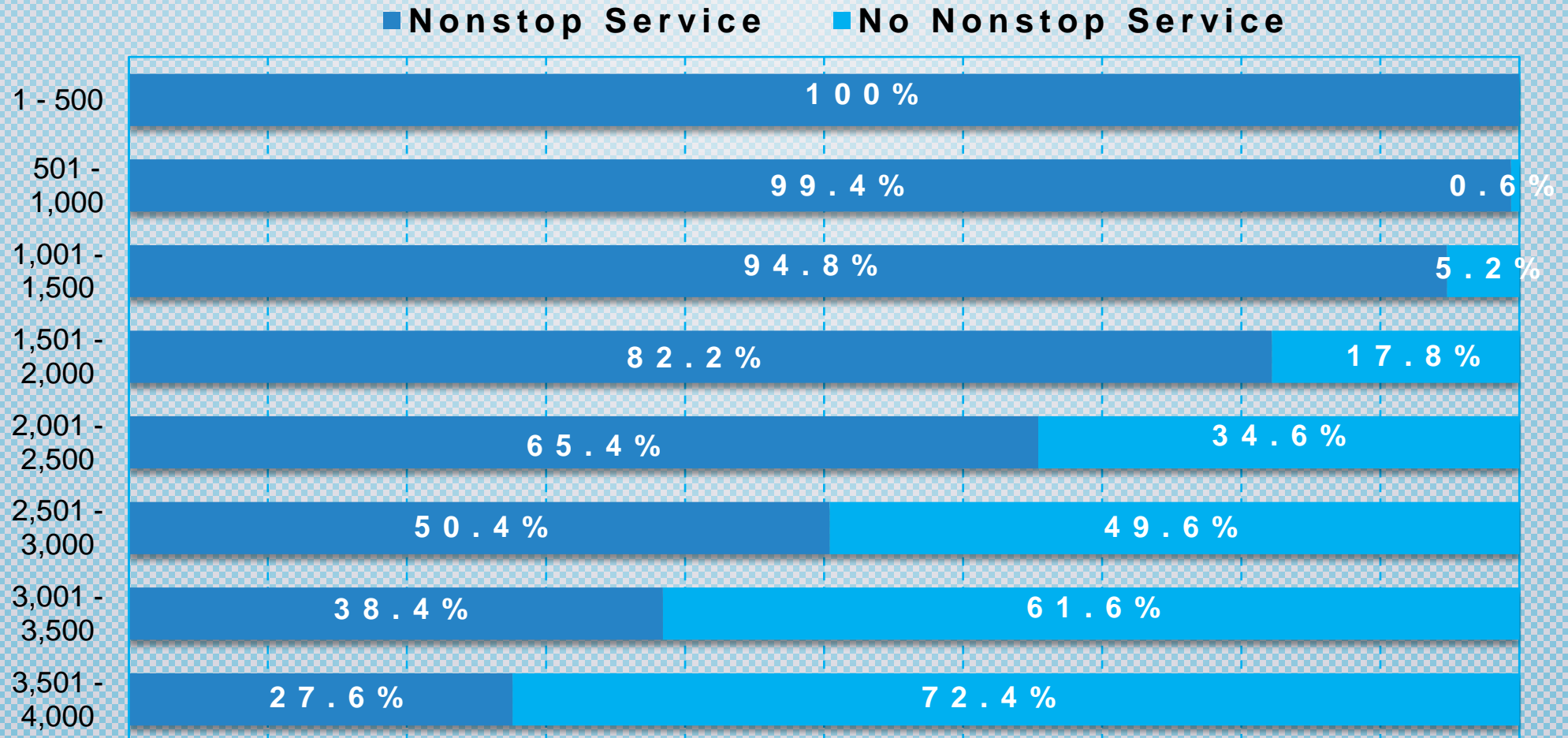




# Only 75.7% of Top 2,000 Domestic O&D Pairs Had Nonstop Service in 2000



# 94.1% Of Top 2,000 Domestic O&D Pairs Had Nonstop Service in 2019



# 10. High Casualty Rate Among New Entrants

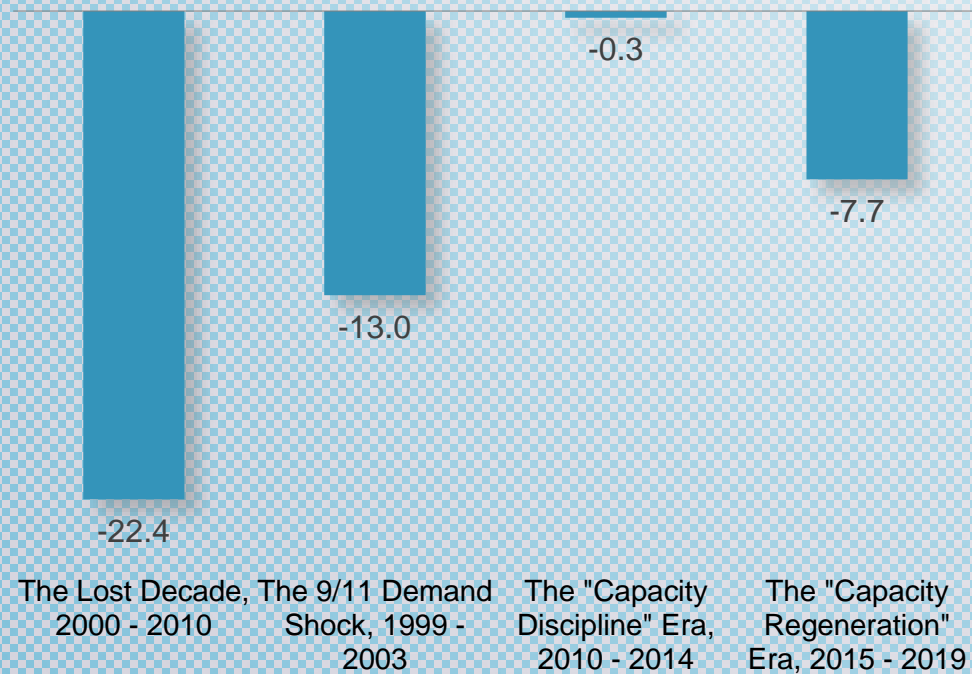
- > History will write that there were many new entrant airlines that did not make it. It will also point to some incumbents too.
- > The last significant upstart was jetBlue in 2000. It was well capitalized with over \$125 million raised at its onset.
  - > Recently both Sun Country and Frontier, the two incumbent ULCCs, each completed their Initial Public Offerings. Being able to “go public” in the middle of a Pandemic suggests clearly that the market likes the simpler operating model.
- > The one attribute that new entrants have are low costs. Low costs along with being well capitalized are the tools necessary to compete in the tumultuous airline world.
  - > Each of the 4 ULCC incumbents (Allegiant, Frontier, Spirit and Sun Country) are well-heeled financially as are the two new entrants Avelo and Breeze.

**HOWEVER, THERE ARE GOING TO BE 7 OTHER CARRIERS COMPETING FOR SOME AMOUNT OF LEISURE MARKET REVENUE IN ADDITION TO THE 6 MENTIONED ABOVE.**

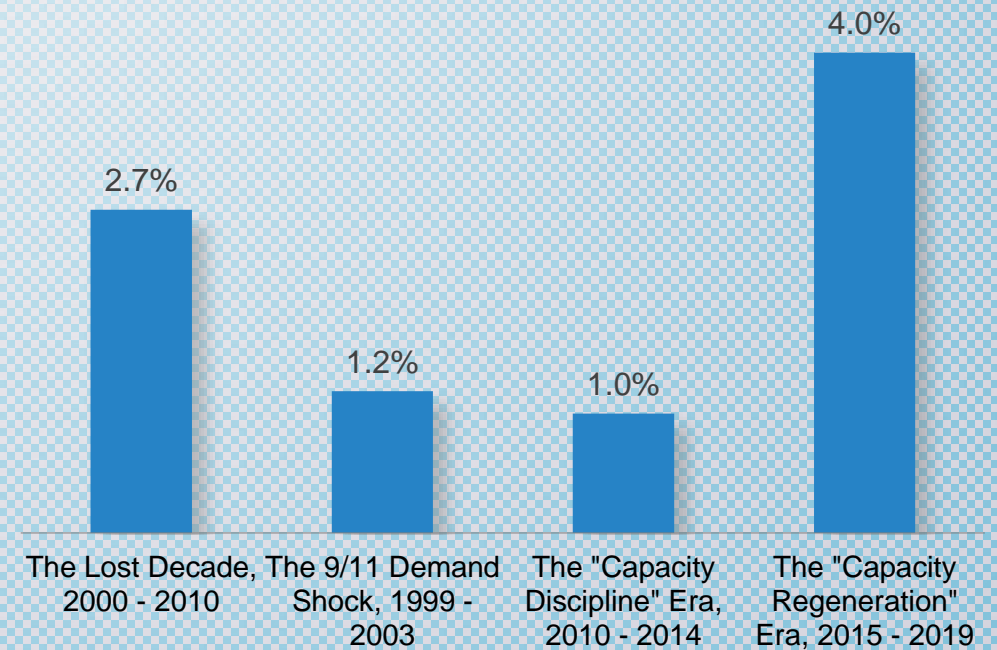


# LOST Average Annual Passenger Revenue and Ancillary Fees v. Average Percent Change in Operating Seats

### Average Annual Passenger Revenue and Ancillary Fees Lost (\$ Billions)



### Average Annual Percent Change in Operating Seats









# Game On!!

## The Pre-Consolidation Terms of Market Fragmentation, Competitive Incursions and Cost Structures Will Reemerge

There will be many iterations of the game called "Prisoners Dilemma" played.

At the time the industry was emerging from the Great Recession, balance sheets were weak as oil had wreaked havoc. Southwest's hedge book was no longer. Between 2010 - 2014, AA, DL, WN and UA were judicious in deploying capacity. Higher unit revenues resulted.

None of these carriers added capacity over the period greater than the rate of GDP growth. It was always a matter of time before one would break from the group by seeing opportunities that would benefit itself.

The game of Prisoners Dilemma was being played. **The prisoner's dilemma presents a situation where two parties, unable to communicate, must each choose between co-operating with the other or not. The highest reward for each party occurs when both parties choose to co-operate. (And that is not likely to happen)**

All players can collectively enrich themselves by restricting output (Capacity Discipline). Each carrier individually has an incentive to break from the group and increase output to capture rents away from others (Capacity Regeneration).

Opportunistic? or putting a marker down? **The game of RESET the domestic commercial aviation playing field is about to begin.**





**SWELBAR·ZHONG**  
CONSULTANCY

Research Lab — Swelbar-Zhong Consultancy  
([Swelbar-ZhongAir.com/Research-Lab](http://Swelbar-ZhongAir.com/Research-Lab))

**William S. Swelbar**  
Swelbar@Swelbar-ZhongAir.com

**Albert Zhong**  
Zhong@Swelbar-ZhongAir.com

C +1-703-625-1130

[www.Swelbar-ZhongAir.com](http://www.Swelbar-ZhongAir.com)