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Introduction

Oligopoly Behavior in the Airline Industry. Case Analysis This case illustrates the pricing behavior of firms that are oligopoly whose market is characterized by the relative few participating firms offering differentiated or standardized products or services. Such firms in an oligopoly have market power derived from barriers of entry that wards off potential participants. As seen in the case, it is clear that because there are a small number of US Airlines firms competing with each other, their behavior is mutually interdependent – thus, the strategies and decisions by one airline management affect managements of the other airlines whose subsequent decisions then affect the first airline.

Airline Industry

In the airline industry, such oligopolistic interdependence gives rise to a strategic behavior akin to chess moves- where, for example, what is best for American Airlines depends on what Northwest Airlines does, and what is best for Northwest Airlines depends on what American Airline does. The small number of firms competing with each other in the airline industry means that one airline's changes in price immediately affects the demand for its competitors. The case suggests that behavior of firms in an oligopoly can be one of cooperation when they all sync their strategies to the obvious disadvantage of the consumer who has few alternatives e.g. inability to substitute other forms of travel for air travel usually because of time and distance constraints.

Case study

As shown by data in the case, oligopolistic behavior can also be ruthless competition among the few firms in the industry. Thus, a lead leading airline would implement price changes at the end of the work week and watch other airlines react over the weekend before it makes adjustments on

Mondays. Failure to follow such a price lead may trigger retaliation as exemplified by the cut-throat price war between American Airlines and Northwest Airlines in March 2002.

American Airlines had taken a leadership role and made changes which, to industry observers and consumers, was an implicit price increase and had hope that competitors would follow suit. When they didn't, the airline retaliated by offering deep cuts in fares on several routes flown by its competitors. Northwest airline responded with a \$198 round-trip fares with connections on routes for which American airline's average fare was \$1,600. American's response was to offer \$99 one way fares in 10 markets flown by each of the other competitors except that of Continental Airlines which had followed and matched the leader's (American Airline) original changes in all markets. With respect to the concept of strategic behavior exhibited by firms in an oligopolistic setting, some firms may try to achieve a dominant strategy that yields them better results and do not flip-flop, no matter what strategies other industry participant follow.

This was illustrated in the case, when, in 2004, Continental Airlines raised its fares to mitigate rising cost of aviation fuel. Firms in an oligopoly may differ in terms of their cost structure and the airline industry is no exception and participants do exhibit strategies that enable them not to follow price increases driven by aviation fuel cost.

For example, when it comes to cost of inputs, such as fuel, the price taken may be different due to hedging (contract to mitigate their exposure to future fuel prices that may be higher than current prices)- a risk management technique to reduce the risk of adverse price movements in a commodity, in this case aviation fuel. Thus, when Continental Airlines raised its fares, low cost rivals such as JetBlue and Southwest refused to follow suit as they had protection through fuel hedging contracts. All the key characteristics of oligopoly market structure and behavior was demonstrated in this case.

Reference.

This discussion is based on Gulliver, "The Big Airlines Get Cold Feet," *The Economist* (Online), February 20, 2011; and Kelly Yamanouchi, "Airlines Keep Adapting to High Fuel Costs," *Atlanta Journal Constitution* (Online), March 4, 2012.

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