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Comparison of Shareholder Value between Full-Service Airlines (FSAs) and  
Low-Cost Carriers (LCCs)

Presented in Partial Fulfillment for the Lee Honors College  
and Bachelor of Science Degree in  
Aviation Science and Administration

By

William Kee  
Western Michigan University  
Lee Honors College and the College of Aviation

December 10, 2015



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### **Abstract**

Shareholders in the airline industry invest in a service industry that is met with high fixed costs, capital, and external factors such as customer satisfaction and fluctuations in crude oil prices. On one end of the airline spectrum in the United States lie the full-service airlines, such as Delta Air Lines, American Airlines, or United Airlines adopting a product differentiation approach to capture a competitive advantage by providing greater benefits, comfort, and experience to the customer. This approach attracts customers that value the experience more so than simply the price of the fare, but is often met with high operating costs such as training, and maintenance inventory in addition to the complexity of having a diverse fleet of aircraft. On the other end of the spectrum lie the low-cost and ultra-low cost carriers which include Spirit Airlines, Southwest Airlines, and JetBlue Airways. The latter of the three airlines, Spirit Airlines, operates as an ultra-low cost approach where any extras are charged to the customer in the form of ancillary fees at the extreme end of the cost leadership approach. While Southwest Airlines and JetBlue Airways are still considered low-cost carriers, the former is known for its free checked baggage, the latter operates a hybrid low cost-product differentiation approach with its premium seating on its transcontinental flights in efforts to gain a competitive advantage. Achieving a competitive advantage and increasing market share is among other performance indicators for enticing shareholders to invest in an airline. This will be discussed in more detail in this thesis and whether a full-service airline or low-cost carrier is better positioned to attract shareholders.



### **Definition of Key Terms**

**Cost leadership.** This is a business-level strategy employed by airline administrators operating at a lower cost, which often results in a reduction in customer-perceived benefit, but would target and appeal to the price-sensitive traveler (Holloway, 2008).

**Competitive advantage.** Within the airline industry, competitive advantage occurs when airline administrators are able to provide a greater level of benefit to customers for the same cost as their rivals or provide the same level of benefit to customers at a lower cost than their rivals, essentially gaining an advantage through a cost leadership or product differentiation strategy (Holloway, 2008).

**Customer loyalty.** Emotional or functional loyalty to an airline, which determines the chance of a traveler flying with the same airline as it relates to the airline industry through the use of customer retention programs to segment and target frequent flyers with the use of consumer loyalty programs low (Holloway, 2008).

**Customer relationship.** Through the use of product customization, consumer marketing and reputation, an airline can customize their services and target different consumer groups through advertising, developing a relationship with the customer while also developing a reputation from how the customer perceives the service's elements and quality (Barney & Hesterly, 2012).



**Customer satisfaction.** Customer satisfaction in terms of the performance of a company, is the individual's appraisal or perception of the company, whether favorable or unfavorable, and whether the performance matches up with the customer's expectation of service quality against any disutility experienced by the customer (Holloway, 2008; Leong, Hew, Lee, & Ooi, 2015). Customer satisfaction is a necessary factor that helps to create customer loyalty, which covers the customer's willingness to provide a positive referral to others and assists in stable revenue generation (Leong et al., 2015).

**Dividend.** A dividend is where shareholders receive a portion of the earnings of a company in the form of shares of a stock, cash, or some other form of property. In the case where the net earnings, or net profit is kept within the company, it is known as Retained Earnings. Dividends occur more often in well-established companies rather than new start-ups because the latter reinvests their profits to help grow the company.

**Earnings per share.** A major variable in determining the performance of a company, earnings per share is the amount of net income after liabilities to other investors are paid, which is then distributed among the weighted average of outstanding shares to the ordinary shareholders (Maynard, 2013).

**External environment.** A broad term encompassing the interrelated elements of technological, economic, demographic, cultural, legal and political, and specific international events that manifest into opportunities or threats within an airline's competitive environment (Barney & Hesterly, 2012).



**Full-service airline.** A full-service airline generally utilizes the product differentiation business-level strategy, provides passengers with a more comfortable traveling experience, and is attributed with a wider global network than that of a low-cost carrier focused on catering to the price-sensitive traveler (Holloway, 2008).

**Internal environment.** A term encompassing the internal tangible and intangible resources and capabilities of an airline that manifest into its strengths and weaknesses through an analysis of the airline's value, rarity, imitability and organization, that may be manipulated by airline administrators to achieve a competitive advantage (Barney & Hesterly, 2012).

**Product differentiation.** A business-level strategy that may be utilized by airline administrators to achieve a competitive advantage through the improvement of the perception of the value created by its service relative to its rivals in terms of factors which may include but are not limited to its global network, reputation, or premium in-cabin amenities (Barney & Hesterly, 2012; Holloway, 2008).

**Revenue model.** A business model, which lends coherence to an airline's strategy towards earning revenues through the configuration of its internal and external resources such as the design of its products and services (Holloway, 2008).



**Shareholder.** A shareholder is the formal owner of a company that would have interest in the positive financial performance of that firm. With corporations, shareholders are not responsible for a company's debt obligations except for the amount that person invested in the company. These shareholders receive a portion of any dividends the company executives decide to declare and a share of the proceeds in case the company in question liquidates.

**Shareholder equity.** Not to be confused with shareholder value, shareholder equity is an accounting term that represents the total amount of a company's liabilities subtracted from the company's total assets. (Investopedia, n.d.). The result from the shareholder equity is used to calculate the value of a company, incorporating the components of outstanding shares, additional paid-in capital, retained earnings, and treasury stock (Investopedia, n.d.).

**Shareholder value.** Shareholder value is a value that is delivered to a shareholder from a company through the use of dividends or increase in share price. Administrators looking to create such value should focus on creating long-term value rather than the short-term goals (Mauboussin, 2011). Airline executives must create the right balance in pricing, and customer and employee satisfaction, while creating value for the company to create sustainable value.

**Strategy.** Actions that together form and support a set of goals in support of achieving a competitive advantage as its ultimate goal, which must be integrated with its strategic management process after the mission has been defined by the airline (Barney & Hesterly, 2012; Holloway, 2008).



**Subsidiaries.** A term that is also known as airlines-within-airlines (AWA) that some network airlines have tried to create to target a separate segment of the traveling consumer market, which are created in large part in response to the threat of the low-cost carrier (Pearson & Merkert, 2014).



### **Introduction**

Airline administrators in today's intensely competitive environment must compete and manage the internal and external environment to satisfy both the customer and the shareholders. These shareholders are, by definition, owners of a company that are not typically involved in a company's day-to-day operation, but benefit from a company's increase in market value through stock market trading. On one side of the airline spectrum, low-cost carriers such as Spirit Airlines have concentrated on a cost-leadership approach, providing low fares to customers while charging fees for any additional services as ancillary revenues. On the other side of the airline spectrum, airline administrators for full-service airlines have primarily adopted the product differentiation approach in establishing premium airport and in-flight services and amenities to attract the customers who value a more comfortable travel experience more so than the price-sensitive traveler.

Strategies have been put in place by airline administrators amidst an external environment that can significantly impact the airline industry through customer preferences, economic stability, or specific severe international events such as the terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001. All this is compounded onto the increasingly competitive environment that exists within the airline industry, where administrators for low-cost carriers are targeting the price-sensitive travelers through a cost leadership approach. On the other side of the spectrum, administrators for full-service airlines are counting on product differentiation to achieve a competitive advantage over their rivals. There have even been some attempts to close the gap between the low-cost carrier and the full-service airline through the use of airline subsidiaries, which have had little to no success, except in the case of JetStar Airways in Australia. This paper will also highlight the implications of negative



publicity events on a customer's emotion and ultimately, the customer's loyalty in an information age. With the help of social media, negative publicity can very quickly and severely impact the general public's perception of an airline.

The internal and external environments within the airline industry are critical factors for airline administrators to consider when managing the resources of any airline, especially in a fiercely competitive industry. Internal tools available to an airline administrator include the physical, financial, individual, and organizational resources of an airline. These tools can be configured in a way to advantage of opportunities or mitigate threats in the external environment such as changes in fuel costs, changes in the political environment, social atmosphere, technological breakthroughs, or environmental issues. Factors of particular importance in the airline service industry are the safety and security of the aircraft as well as customer satisfaction. This paper will analyze some of the specific factors in the internal and external environment that airline administrators need to be aware of, especially in today's information age where buyer power and the voice of customers can translate into severely impacting the financial performance of an airline through reviews and the American Customer Satisfaction Index (ACSI). This paper will also highlight the cost and revenue models as it relates, respectively, to the internal and external environments.

Product differentiation is a business-level strategy that is based out of the revenue model, which focuses on maximizing revenues. This strategy is utilized by administrators for full-service airlines such as Delta Air Lines, Emirate Airlines, and Lufthansa Airlines to name a few. In addition to competing with other full-service airlines, airline administrators for these airlines must now also compete with low-cost carriers in order to stay competitive, especially during times of economic uncertainty, by implementing cost efficiency measures in conjunction with



creating a distinct and differentiated product. While some airline administrators choose to differentiate its airline through premium amenities and services, a core factor in differentiating an airline from its rivals would be its policy and performance on its customer relationships and satisfaction. In the modern information age of the early 21<sup>st</sup> century, the average passenger is greatly empowered through the use of the Internet and social media platforms such as *Facebook*, *Twitter*, and *YouTube*. Through this empowerment, customer satisfaction is closely correlated to an airline's reputation, and ultimately, related also to the airline's competitive advantage.

Cost leadership is a business-level strategy that is based out of the cost model, which focuses on reducing costs in order to charge a lower fare catered towards the more price sensitive travelers. This strategy is widely believed to have begun in the United States, with the successful strategic operation of Southwest Airlines. It is typically implemented by administrators of low-cost carriers, but recent developments have shown that such a strategy is not exclusive to that category of air transport carrier. Full-service airlines have begun to implement low price options for their customers, which have rigid restrictions on what the passenger can or cannot do in terms of changing flights, times, seats, or cancelling their itinerary altogether. As airlines become increasingly scrutinized by the mainstream media along with increasing scrutiny from existing and potential customers, airlines need to be increasingly vigilant in providing a safe and sanitary environment in which travelers can reach their destination in a timely and relatively inexpensive manner.



## **Literature Review**

### **Strategies and Business Models**

Airline administrators today operate in an industry where they must adapt to a constantly changing external environment by developing and implementing strategies appropriate to any given scenario. In order to do this, these airline administrators need to understand the dynamics of the airline industry and its competitive nature in order to achieve a competitive advantage. They also need to understand the demographics of the customers who travel, because there are price-sensitive travelers who will only travel with the airline with the lowest possible price, such as Spirit Airlines, while other customers are willing to pay a premium price for amenities and services such as airport lounges or premium cabins for a more comfortable flying experience. With increases in competition, airline administrators had been forced to develop strategies, new business models (being the cost and revenue models), develop new innovations to become more efficient, or face mergers or the possibility of declaring bankruptcy (Fu, Oum, & Zhang, 2010).

Strategy is an important subject for airline administrators to consider because an effective or ineffective business strategy can mean the difference between a successful airline and a failure. Barney and Hesterly (2012) described strategy as “a firm’s...theory of how to gain competitive advantages” (p. 24). Without a competitive advantage, any firm existing within the modern competitive environment of the early 21<sup>st</sup> century, would not have been seen by consumers as having any more of an “economic value than [its] rival firms” (Barney & Hesterly, 2012, p. 10). Choosing an effective strategy for the firm through the strategic management process, “requires that a firm engage in an analysis of threats and opportunities” (Barney & Hesterly, 2012, p. 59) which involve 6 areas within the general environment: “technological



change, demographic trends, cultural trends, economic climate, legal and political conditions, and specific international events” (Barney & Hesterly, 2012, p. 59).

Some of these threats introduced by authors Franke and John (2011) include the economic downturn of the 2001 crisis as a result of the “bursting of the dot.com bubble” (p. 19) and the September 11, 2001 terrorist attacks (9/11). These would be considered as a threat from the economic climate as well as severe and specific international events from the general environment. In relation to the 9/11 terrorist attacks in particular, the aftermath of the attacks resulted in a significant drop in demand levels for air travel world-wide (Franke & John, 2011). Air transport demand did not return to its former levels until 2004, which was in part due to a double-dip effect as a result of the severe acute respiratory syndrome (SARS) pandemic threat in 2003. This presented an opportunity for the administrators for the low-cost carriers.

Administrators for low-cost carriers used a cost leadership approach which earned them a competitive advantage for the increasing number of price-sensitive travelers. In addition, the simplicity of the low-cost carrier revenue model with “few restrictions on ticket usage” (Holloway, 2008, p. 32), schedule reliability and a simple point-to-point price structure were appealing to passengers. The cost model for these low-cost carriers allowed them to pass along operational cost savings in the form of low prices for tickets; cost model decisions were aligned to the business strategy by having one type of aircraft in the fleet and not using premium airport services (Holloway, 2008, p. 34). With the onset of the 2008 global recession, global air traffic had decreased by 6.1% for 2009 according to the International Air Transport Association (IATA) (as cited in Franke & John, 2011, p. 20). Airline administrators had to review their internal strategies to become more efficient and stay competitive in a saturated low-cost carrier market.



One of the strategies used was the concept of airline subsidiaries. “The continued growth in the [low-cost carrier] airlines from their traditional domestic markets represents an increasing and significant threat to the long-term viability of the legacy airlines” (Taneja, 2010). The administrators for these legacy airlines, or full service airlines (FSAs), who traditionally use product differentiation through a revenue model approach, wished to counter this threat by launching subsidiaries, or “colloquially known as airlines-within-airlines (AWA)” (Pearson & Merkert, 2014, p. 21). Pearson and Merkert (2014) continued to explain that for the airline subsidiaries, with 31 currently operating airlines-within-airlines, 18 of those operate within the Asia-Pacific region. In addition to this, another four proposed subsidiaries indicate “that this region is at the forefront of AWA development” (Pearson & Merkert, 2014, p. 25).

Administrators for these legacy airlines had difficulty with balancing out the operational costs of their subsidiaries and also did not have the first-mover advantage that benefited experienced low-cost carriers such as Southwest Airlines, Air Asia, or Ryanair (Pearson & Merkert, 2014, pp. 25–26). In addition to this, the poor planning and poor strategy development caused the AWA strategy, which in the case of the United States (U.S.) and Europe, “virtually all [low-cost subsidiary] (LCS) airlines in these markets failed” (Homsombat, Lei, & Fu, 2014, p. 3). The reason for the continued growth of AWAs in Asian countries continue to be somewhat ambiguous to researchers (Homsombat et al., 2014) because while this practice had not been successful in the United States and Europe, international and domestic markets in Asia have experienced at least one particular success story. Similar to how other FSAs have created a subsidiary as a reactionary measure to low-cost carriers but failed, administrators for JetStar Airways, which is owned entirely by Qantas Group, have done the same and have “achieved



very promising results in terms of traffic growth and financial returns” (Homsombat et al., 2014, p. 12).

While these strategies of using airline subsidiaries are more of a cost leadership approach to counter the increasing market share of low-cost carriers, there are still less price-sensitive travelers who are willing to pay for a little more comfort. However, problems began to occur when administrators for airlines try to do too much. Within North America and Europe in particular, “network carriers...have made significant and often painful efforts to narrow the gap between their unit costs and those of low-fare carriers...[but] there are structural reasons why the gap can never be eliminated” (Holloway, 2008, p. 32).

Oliver (as cited in Forgas, Moliner, Sánchez, & Palau, 2010, p. 229) described loyalty as “the transition from a favorable predisposition (affective loyalty) to a repeated purchase commitment (conative loyalty) as a prior step to the action of purchase...[and that] true loyalty begins...when emotional ties between customer and company are established” (p. 229). In addition to the emotional connection, there also must be trust and perceived value in the eyes of the customer (Forgas et al., 2010, p. 230). McCartney (2014) explained that “airlines have crammed in more seats ...filling higher percentages of their seats on planes, meaning more battles for overhead bin space and elbow room” (para. 4). Certain FSAs such as United Airlines or Delta Air Lines offer premium economy seats, available for no charge to “top-tier frequent fliers” (McCartney, 2014b, para. 3) and a specified fee for other travelers. This would mean that passengers are still either willing to pay for extra comfort or have traveled enough with an airline to have an established expectation of the quality of service.

There have been a number of incidents regarding the reclining of these seats where one passenger had reclined into another, which had led to a dispute while the aircraft was in flight.



“Southwest Airlines at one point reduced how far its seats would track back” (McCartney, 2014b, para. 5) recognizing the fact that tighter seat configurations meant “crashing into the space of the person behind you, [making it] impossible to work on a laptop in a standard coach seat if the person in front of you reclines” (McCartney, 2014b, para. 4). Knowledge of this in advance of the planning of the seating configuration would have a positive impact on customer loyalty as opposed to Delta Air Lines’ approach by increasing the recline, but having negative publicity due to one passenger reclining into another (McCartney, 2014b, para. 5). This negative publicity, especially if it is broadcast around the country, would have a negative impact on the emotional ties to any loyalty a customer may have towards an airline. Today’s information age no longer conforms, as stated by Deighton “[to the] old world of Super Bowl ads and [reaching] prime-time audiences” (Hanna, 2010, para. 4). These prime-time advertisements would cost millions of dollars, whereas today, someone only needs to be connected to the Internet to access a wide range of information. In stark contrast to the prime-time advertisements, the song posted by Canadian musician Dave Carroll, the producer for the viral music video *United Breaks Guitars* (see URL: <http://www.youtube.com/watch?v=5YGc4zOqozo>), was only “produced for \$150... [caught the] attention of a multi-billion dollar corporation... [and had reached the] mainstream media” (Hanna, 2010, para. 2–3) and an audience of 4.6 million within the span of a month. As Forgas et al. (2010) explained how there must be trust and perceived value from the customer’s point of view; such mistreatment of baggage would have a negative impact on a customer’s emotional opinion of the airline, namely United Airlines in particular, which would affect customer loyalty.

While there are some external events that cannot be foreseen, airline administrators must remain vigilant in understanding their rivals and the competitive environment of the airline



industry. Additional research needs to be done to understand why airline subsidiaries has seen success with JetStar, but have seen failure in the U.S. and European markets. It is also important for airline administrators to be responsive to the external environment and to customer issues, especially in today's modern world where information is readily available to anyone with an Internet connection. Failure to be responsive in these scenarios could mean a loss of consumer confidence, through their emotions about an airline. This would lead to a loss of customer loyalty and eventually, the revenues of the airlines. Ultimately, however, airline administrators must be vigilant in maintaining their competitive advantage, through the use of either their cost or revenue models to differentiate themselves from their rivals.

### **The Internal and External Environment**

Airline administrators need to be aware of the internal and external environment that affect the industry in which they operate in order to effectively manage an airline. External environmental factors can be categorized into the five categories in the PESTE model, being political, economic, social, technological, and environmental factors; any of these factors can change at any time, and without warning. Also within the external environment is the American Customer Satisfaction Index (ACSI), which “measures the satisfaction of U.S. household consumers with the quality of products and services offered by...firms with significant share in U.S. markets...[by surveying] roughly 70,000 customers...[per year] about the products and services they use the most” (ACSI, 2014, para. 1). Internal factors include the organizational, individual, physical, and financial resources of a company as well as its strengths and weaknesses that can be configured to help neutralize or mitigate the threats or take advantage of opportunities from the external environment (Barney & Hesterly, 2012).



The four internal resources according to Barney and Hesterly (2012) include physical, financial, individual, and organizational resources, which are interrelated and help form a “coherent contribution to...[an airline’s] strategic theme” (Holloway, 2008, p. 23). A physical resource analysis would represent physical equipment and technology used for an airline; noted when Executive Vice President Nico Buchholz, fleet management for Lufthansa Airlines, wanted “an aircraft...larger than...the current families’ of narrowbodies” (as cited in Wall, 2014, para. 2). Continuing this theme, Michael Powell, Chief Financial Officer for Europe’s Wizz Air Holdings, stated that “a new design would...provide an opportunity for a new manufacturer to challenge the duopoly for jetliner production above 150 seats where Airbus and Boeing rule” (as cited in Wall, 2014, para. 11). These are examples how an internal analysis made by these airline administrators determined that they had a need for an aircraft manufacturer to design a new type of aircraft. It is also important to assess the individual resources or human resources, which “include the training, experience, judgment, intelligence, relationships, and insight of *individual* managers and workers in a firm...[such as with] Southwest Airlines, [where] each employee...is seen as essential for [its] overall success” (Barney & Hesterly, 2012, pp. 66–67).

To highlight the financial aspect of an internal analysis, airline administrators for low-cost carriers (LCCs) have used the cost model to conduct a cost leadership approach. According to Brügger and Klose (2010), “fleet commonality is pivotal for the low-cost airline model because a carrier can enjoy...significant cost advantages over competitors with diversified fleets” (p. 300). Additionally, in exercising this fleet commonality, crews can be interchanged more easily than airlines with a diversified fleet, less training is required, and maintenance and servicing tools and parts can be standardized, which is directly in line with reducing costs. In exercising the cost leadership approach, this increased cost efficiency in operations would



ultimately create a competitive advantage, which would appeal to the price-sensitive travelers (Brüggen & Klose, 2010; Low & Lee, 2014). In addition, researchers Low and Lee (2014) promoted the option for airline administrators to pursue the acquisition of more aircraft to “expand their network to serve routes of longer distances...[which can] differentiate [full-service airlines] against low cost carriers, ...which mostly provide point-to-point short distance connections” (p. 30).

Another way of analyzing the internal capabilities of an airline would be a “resource-based view (RBV), [which can be used to] model [a firm’s] performance [while focusing] on the resources and capabilities controlled by a firm as sources of competitive advantage” (Barney & Hesterly, 2012, p. 66). Researchers Low and Lee (2014) made use of this “RBV model to undertake a longitudinal analysis on the competitiveness of 114 major international passenger airlines using observational data” (p. 23). They discovered that as a result of advances in technology, airline administrators can place a greater focus on Internet sales and ticketing to reduce labor costs and increase market share and profitability (Low & Lee, 2014).

According to Barney and Hesterly (2012), “a firm’s mission...define both what a firm aspires to be in the long run and what it wants to avoid in the meantime” (pp. 4-5). In addition to the internal analyses, airline administrators need to examine their external environment because “competitive strategy is driven [by not only] internal, firm-specific considerations, [but also] the structure of external markets” (Holloway, 2008, p. 205). According to Barney and Hesterly (2012), the general environment that a firm operates “[consist] of six interrelated elements: technological change, demographic trends, cultural trends, the economic climate, legal and political conditions, and specific international events” (p. 30). However, neither internal nor external environments occur completely independent of each other. For example, customer



satisfaction is a factor that can very rapidly affect the general public's perception of the airline through word of mouth as well as econometric performance benchmarking via the American Customer Satisfaction Index (ACSI).

The results from ACSI, which assesses key customer satisfaction drivers such as the “ease of the check-in process...courtesy and helpfulness of flight crew...boarding experience [and] quality of in-flight services” (ACSI, 2014b, para. 6) can direct airline administrators to leverage their individual or organizational resources to take advantage of an external opportunity or mitigate an external threat. As airlines are service organizations, a positive “customer experience can be the most valuable asset...[where] contact employees...play a critical role in shaping [those experiences]” (Babbar & Koufteros, 2008). Donnelly (as cited in Babbar & Koufteros, 2008) stated, “the mission of Southwest Airlines is dedicated to the highest quality of Customer Service delivered with a sense of warmth, friendliness, individual price, and Company Spirit” (p. 825). While airlines in the United States “seem to fall short of the standard...[of service quality], Southwest Airlines has shown [that] it is indeed possible to be successful and consistently profitable in an intensely competitive industry” (Babbar & Koufteros, 2008, p. 825).

An external factor affecting airlines is the price of crude oil, which had “yielded significant elasticity estimates...[indicating] rising oil prices [had] a detrimental effect on tourism demand [through the rise of the air fares]” (Seetaram, 2010, p. 32). Airline administrators can respond proactively to the threat of higher crude oil prices by analyzing the fuel and weight efficiency of its aircraft by choosing more fuel-efficient aircraft. Another method for airline administrators to consider could be the reduction of the weight of on-board cabin items, training programs to help pilots taxi or fly in a more fuel-efficient manner, or reductions in non-essential fuel loads but still satisfy the Federal Aviation Administration alternate airport requirements.



There has been evidence of companies that have benefited from a first-mover advantage in other industries, but there is a significant risk for firms' administrators who make the first move in adopting a new kind of technology. Tellis (2014) stated that first-mover advantages are not as advantageous as some scholars claim it to be. Market leaders today such as *Microsoft* in operating systems, *Apple* in relation to music on-the-go, *Amazon* in online book stores, and *Google* in terms of Internet searches were not pioneers in their respective specialties, yet they are vastly more successful than the first-movers in each of the aforementioned business sectors (Tellis, 2014). In relation to the Boeing 787 *Dreamliner*, a statement made by Calin Rovinescu, the Chief Executive Officer for Air Canada in 2013, stated the "attention...the 787 received...as a result of a number of technical problems...[reconfirmed] the wisdom of avoiding the 'first mover' step and [wait] to take delivery of a new aircraft model only after the initial problems are fixed" (as cited in Deveau, 2013, para. 3). This was in the aftermath of the grounding of the Boeing 787 fleet as a result of "two incidents involving the aircraft's lithium-ion batteries catching fire" (Deveau, 2013, para. 9), which would have a negative effect on an airline's revenues in addition to causing an inconvenience to the passengers scheduled to be on that aircraft. This would cause a decrease in customer satisfaction, especially for time-sensitive travelers who need to get to their destinations on time.

Airline administrators have used a revenue model to pursue a product differentiation strategy through the introduction of premium economy seats, which can be seen as a response to a poor ACSI rating for seat comfort in conjunction with the mediocre score for in-flight services; both are considered as "the most important in terms of customer satisfaction" (ACSI, 2014c, p. 3). To connect with the *millennial* generation, airlines need to pursue "the full potential of mobile devices in terms of engaging with passengers, improving the customer experience,



cutting costs, and increasing revenue” (Taneja, 2010). Social networking sites such as *Facebook*, *Twitter*, or *YouTube* are commonly used platforms for customer complaints, such as the example with the music video *United Breaks Guitars* by musician Dave Carroll, which was widely reported in the media, and was triggered by the breaking of the musician’s guitar by United Airlines’ baggage handlers (Taneja, 2010). To mitigate such threats, airline administrators need to deploy human resources to address customer complaints on social media, which can have a positive effect on demonstrating that they care about their customers (Taneja, 2010).

It is important for airline administrators to understand how the internal and external environments relate to one another, and how they can leverage their resources to mitigate external threats or take advantage of external opportunities. Airlines need to maintain its pace with today’s modern tech-savvy generation in using mobile devices and social media. Benchmarks such as the ACSI can be useful tools for airline administrators to see where customer satisfaction levels are lacking to empower them to implement plans and solutions to create a better customer experience and ultimately, a competitive advantage.

### **Product Differentiation**

All airline administrators make use of a revenue model and a cost model, but it is the implementation of either the cost leadership or the product differentiation business-level strategy that determines the framework for how the airline is structured. Barney and Hesterly (2012) defined product differentiation as “a business strategy [where] firms attempt to gain a competitive advantage by increasing the perceived value of their products or services relative to the perceived value of other firms’ products or services” (p. 132). Porter (as cited in Holloway,



2008) stated that “one purpose of product differentiation is to reduce cross-price elasticity by weakening the perception that competing products are real substitutes” (p. 85). Unlike administrators for low-cost carriers, who achieve a competitive advantage through lower costs and lower fares, administrators for full-service airlines, who use the product differentiation approach, implement “innovative product design[s], the development of a strong brand image, and the nurturing of a loyal customer base” (Holloway, 2008, p. 160) with the help of frequent flyer programs in order to maximize their revenues. In addition to the frequent flyer loyalty programs, according to Cento (2009), full-service airlines are typically characterized by a global hub-and-spoke network, as well as membership within an airline alliance.

One of the major threats to the administrators of these full-service airlines is the low-cost carrier. Button (as cited in Hazledine, 2011) stated that in “the analytical context of the ‘empty core’ hypothesis,...large fixed costs incurred by [full-service airlines] make it difficult...for them to set prices adequate to cover all their costs without those prices being well above marginal variable costs” (p. 130). As a result, full-service airlines become “vulnerable to marginal cost pricing by rivals...[such as] low cost carriers [that have lower] fixed costs of their own to cover because of their flexible, route profitability-based business model” (Hazledine, 2011, p. 130). While some administrators for full-service airlines such as Air New Zealand tried to cut costs through reducing meals and business class seats, other airline administrators can focus on product attributes and services, relationships between the customer contact employees and the customer, or linkages between firms, such as a global airline alliance network (Barney & Hesterly, 2012). Cento (2009) mentioned that full-service airlines have “used a combination of stronger revenue growth and higher efficiency gains to offset the large impact of higher fuel costs...[through the use of] fuel hedging...to protect against the shock of anticipated rises in [fuel]



prices” (p. 27). Airline administrators are aware that more weight on board the aircraft increases fuel burn, and therefore increases costs. Thinner and more lightweight seats have been installed on board airlines such as Delta Air Lines, United Airlines, meaning that they are no longer relegated to the realm of “ultra-cheap and charter operators” (McCartney, 2014c, para. 2). This, however, comes at the cost of customer satisfaction, which according to a survey by *TripAdvisor* (as cited in McCartney, 2014c) “83% said [the new, thinner seats] were less comfortable than traditional seats” (para. 9).

Airline administrators have achieved a “greater cost efficiency...[through lowering] their...distribution and overhead costs [with emphasis on]...non-fuel unit costs...since 2001” (Cento, 2008, p. 43). Such “cost efficiency can also be achieved by mergers or acquisitions, [which] has started mainly in Europe between the [full-service airlines]...but also between [low-cost carriers] (LCCs) (Cento, 2008, p. 41). An example of this was the “acquisition of KLM Royal Dutch Airlines by Air France in 2004...[gaining a greater] European market share, particularly among high-paying business [travelers] on long-haul flights” (Cento, 2008, p. 41). However, such acquisitions and mergers may have a negative effect on customer satisfaction. Following the “2010 merger with Continental [Airlines], United [Airlines was] still struggling with passenger service...[which translated into] the lowest [American Customer Satisfaction Index] (ACSI) score in the [airline] industry” (ACSI, 2014b, p. 1). ACSI Chairman and Founder, Claes Fornell (as cited in American Customer Satisfaction Index [ACSI], 2014b) stated “time and time again, the negative impact [that] mergers have [had] on customer satisfaction” (p. 1) noting the effects of Delta Air Lines’ merger with Northwest Airlines as well as the merger with Southwest Airlines and AirTran Airways in addition to the United-Continental merger.



Membership within global airline alliances such as *Star Alliance*, *oneworld*, and *SkyTeam* can be very beneficial for airline administrators implementing a product differentiation business-level strategy because such membership can “influence consumer purchase intention by enhancing the customer’s perception of brand equity and brand preference (Wang, 2014, p. 58). Wang (2014) also stated that the “highly involved consumers, [which] represent the relatively active passengers...[willing] to interact more with airlines and fly more frequently...care about whether or not the target airline joined a global airline alliance, while the lowly involved customers [did] not” (p. 58). Additionally, the behavior of the infrequent traveler would hold less weight than frequent flyers because they “can only evaluate the benefits of global airline alliances based on their expectations or from very limited experiences...[nor would they] experience specific [top-tier] benefits of an airline” (Wang, 2014, p. 58).

One of the starkest examples of product differentiation in aviation history was the Aérospatiale-British Aircraft Corporation (BAC) Concorde with its supersonic speeds that could not be matched by any other commercial aircraft available to the general public, until its eventual retirement in the early twenty-first century. In the value-rarity-imitability-organization (VRIO) framework as described in Barney and Hesterly (2012), supersonic travel would have fallen into the rarity category in the most extreme scenario while providing value to the extremely time-sensitive travelers. Administrators for full-service airlines achieve a greater flexibility in pricing when they sufficiently differentiate their products from their rivals to achieve a competitive advantage (Barney & Hesterly, 2012). The issue with the Concorde was the premium pricing necessary to cover the operating costs was prohibitive in the market place; the Concorde service was so differentiated [the only in its kind] that it became a niche in which a few could afford. As such, supersonic air travel underscores the customer-driven ceiling price is determined by the



aggregate maximum reservation price passengers are willing to pay (F. Esquibel, personal communication November 7, 2014).

It is not sufficient for airline administrators to depend solely on differentiators in on-board amenities or aircraft configurations. Rhoades and Waguespack (Babbar & Koufteros, 2008) stated that “passengers may use service quality [through interactions between customer contact employees and customers] as a basis for judging the overall quality of an airline” (p. 805) thus affecting the reputation of the airline. This reputation is possibly “the most important...socially complex relationship between a firm and its customers...[that] can last a long time, even if the basis for that reputation no longer exists” (Barney & Hesterly, 2012, p. 136). Babbar and Koufteros (2008) also stated that “empirical evidence...shows that individual attention, helpfulness, courtesy, and promptness embedded in the element of personal touch shape the experience of airline customers and determine their level of satisfaction with the airline” (p. 824).

An example of an airline using this strategy is Emirate Airlines, simply known as Emirates, which is based out of Dubai in the United Arab Emirates in the Middle East (“The remarkable record of Emirate Airlines: Product differentiation and cost control deliver exceptional performance,” 2012). Emirates pursues this approach by drawing “attention to its strategy as a high-quality provider, delivering a superior customer experience and focusing on the details making up that experience...[in order to] highlight the quality of its customer service and in-flight passenger comfort” (“The remarkable record of Emirate Airlines: Product differentiation and cost control deliver exceptional performance,” 2012, p. 11). Other airlines based within the United States have made efforts to improve on its customer relations through being “more aggressive about intercepting [customer complaints] with emailed surveys and



social media” (McCartney, 2014a, para. 5). Delta Air Lines’ Senior Vice President of airport customer service, Bill Lentsch, (as cited in McCartney, 2014a) stated that “Delta worked...[on] minimizing taxi times, as well as speeding up loading and unloading” (para. 13) to minimize passenger waiting times. Another example of an airline being responsive to customer satisfaction is Southwest Airlines. Southwest’s Chief Operating Officer, Mike Van de Ven, (as cited in McCartney, 2014a) stated, that “Southwest is upgrading baggage sorters and equipment...at its major airports” (para. 23) in response to Southwest’s worst ACSI baggage handling score “among the nine carriers in the scorecard...[which reflects] the heavy volume that comes from not charging baggage fees but also the airline’s willingness to accept bags late for check-in” (McCartney, 2014a, para. 22).

Airline administrators for Qantas Airways use the product differentiation strategy to create a more premium experience for its premium class passengers by beginning “construction on [a] new Domestic Business Lounge at Perth Airport...available to Qantas business class customers, Platinum, and Platinum One Frequent Flyers” (“Australia: Qantas adds lounge capacity in Perth with announcement of new business lounge,” 2014, para. 2). The domestic Head of Customer Strategy for Qantas Airways, Philip Capps, (as cited in “Australia: Qantas adds lounge capacity in Perth with announcement of new business lounge,” 2014) stated that its dedicated Qantas precinct at Perth Airport “will deliver a better travel and airport experience for Qantas customers as a result of improved gate access, faster security screening, quicker check in and now more lounge facilities” (para. 4) equipped with premium facilities “which are...unique [to] the domestic Australian market and [would] provide competitive differentiation” (para. 11). These are premium profits available to administrators for full-service airlines who cater to the



travelers who value the experience over low airfares in addition to safely arriving at their destination.

Complexities in full-service airlines are found through its division of premium and economy classes, an airline's fleet, its cabin configuration, as well as an airline's fare structure. American Airlines had "pioneered complex, differentiated pricing, which had clearly been a competitive advantage when it was introduced following the deregulation of the U.S. domestic airlines industry" (Bonabeau, 2007, p. 68). According to Bonabeau (2007), "complexity is often viewed as the cost of doing business, even as a means to obtaining a competitive advantage" (p. 67). While some low-cost carriers have attempted a simpler pricing structure such as with Southwest Airlines, an attempt by American Airlines to simplify the pricing structure in April of 1992 resulted in "intense price competition from other airlines...destroying value for the entire industry and forcing American Airlines to drop the [simplicity] plan within weeks" (Bonabeau, 2007, p. 68).

While cost leadership focuses on reducing costs, administrators implementing a product differentiation strategy focus on delivering a positive and differentiated experience to the passenger through customer contact employees and services offered by the airline. Complexity within an airline's structure can be important for the success of a full-service airline using the product differentiation strategy in order for airline administrators to sufficiently differentiate itself from its rivals. It remains critically important for airline administrators to be able to respond effectively to customers when handling customer complaints. With today's technology and social media, one bad customer's experience can translate into a negative impact on an airline's reputation. Global airline alliances in conjunction with frequent flyer programs are ways for administrators for full-service airlines to attract and maintain its customer base.



Additionally, non-price sensitive passengers who grow to expect to receive a positive experience with an airline would be more likely to fly with that airline in the future.

### **Cost Leadership**

Airline administrators utilizing the cost leadership business-level strategy are generally administrators of low-cost carriers (LCCs) that cater to the price-sensitive travelers. The cost leadership or cost advantage approach as described by Holloway (2008) notes that operators of such airlines have lower costs than that of their rivals. This lower-cost approach can manifest itself in two ways: benefit parity or benefit reduction (Holloway, 2008). Airline administrators using the benefit parity approach offer the same benefits to their customers as their rivals, but at a lower cost, allowing the airline administrators to capture a greater profit margin (Holloway, 2008). The other approach is benefit reduction, where the benefits offered by airline representatives and managers are less than that of their competitors in an effort to reduce costs, which may still appeal to the price-sensitive traveler who is mainly concerned about just getting to their destination safely (Holloway, 2008). For both of these approaches to the cost leadership business-level strategy, the reduction in costs allows the airline administrators to reduce the prices that are charged to the customers, or travelers, to achieve a competitive advantage in the mindset of the price-sensitive traveler.

Following the Airline Deregulation Act of 1978, the United States was one of the first countries to “witness the emergence of [low-cost] carriers (LCCs)...as a viable form of commercial air transportation (Gross & Lück, 2013). The United States was especially suited for this type of carrier because of its large spatial area of “over 9.5 million square kilometers, [making it] the third largest country in the world by geographic size” (Gross & Lück, 2013, p.



63). This business strategy was emulated with the introduction of new low-cost carriers in Europe and Australia in the form of a completely new flight department, such as Ryanair in Ireland, or a subsidiary of a major airline such as JetStar Airways, owned wholly by Qantas Airways (Gross & Lück, 2011). Button (2014) described the low-cost carrier model, which is the type of airline most likely to implement a cost leadership strategy, as the ‘Southwest effect’ – basically the drop in fares that occur when a low-fare airline begins serving an airport that had previously had no low-fare carriers.” The first successful airline to implement the low-cost model was “Pacific Southwest Airlines...which pioneered the concept in 1949” (Button, 2014, p. 201). The airline administrators for low-cost carriers such as Southwest Airlines “seek to attract traffic from competitors in the short term, while generating new traffic to cover their immediate costs, with the hope of forcing traditional carriers from the market [so they can] enjoy some degree of monopoly power” (Button, 2014, p. 203). Meanwhile, administrators for these low-cost carriers typically operate out of secondary airports and with point-to-point structures, which has advantages in reducing congestion and are often without capacity restrictions (Gross & Lück, 2011).

Broad differentiation strategies employed by low-cost carriers “remove some elements of cost from their production functions and reduce the levels of many of the remaining costs” (Button, 2014, p. 204). This means that benefits that may be offered by full-service airlines may be reduced as part of a benefit reduction strategy, which would have an effect on reducing the operational costs of the airline. In some cases, airlines “charge separately for the attributes they do offer, which vary among low-cost airlines” (Button, 2014, p. 204). A common example of this benefit reduction approach of the cost leadership business-level strategy is that of Spirit Airlines. Administrators for Spirit Airlines have chosen a kind of *a-la-carte* approach for its



extremely price-sensitive travelers, who seek to get to their destination for the lowest possible fare. Spirit Airlines' "cut-rate fares include little more than a seat, with nearly everything else sold a la carte...from boarding passes to drinking water" (Nicas, 2012, para. 1, 3).

Another example of the benefit reduction approach was introduced to Ryanair Ltd., which is headquartered in Dublin, Ireland, by Chief Executive Officer Michael O'Leary in 1991, after studying the success of Southwest Airlines in the United States' domestic travel market (as cited in Barney & Hesterly, 2012). Like Southwest Airlines, airline administrators for Ryanair chose to operate a uniform fleet of Boeing 737-800 aircraft in addition to saving costs in installing non-reclining seats and removing window shades from their aircraft (Barney & Hesterly, 2012). This strategy in addition to charging customers for ancillary fees in a similar fashion to Spirit Airlines, such as for checked bags or onboard snacks, and enabling companies to advertise space in the cabin of their aircraft, allow Ryanair's airline administrators to earn a comfortable profit margin despite having lower average fares than Southwest Airlines (Barney & Hesterly, 2012).

These two examples are in stark contrast to the opposite end of the airline industry spectrum – the full-service airlines that cater to the less price-sensitive passengers seeking an all-inclusive and more comfortable flying experience. Unlike the full-service airlines, airlines such as Ryanair focus on "gaining advantages by reducing its costs to below those of all its competitors" (Barney & Hesterly, 2012, p. 104). The strategies employed by airline administrators of Spirit Airlines and Ryanair Ltd have seen their share of controversy and unpopularity as indicated by Spirit Airlines' dismal score of 54 in 2015 by the American Customer Satisfaction Index (ACSI) versus the airline industry benchmark average of 71, and a survey of 4,000 readers on a *TripAdvisor* website that revealed Ryanair as the most disliked



European airline (ACSI, 2015a; Barney & Hesterly, 2012). Additionally, *Skytrax*, which is an international air travel ratings and reviews organization, finds both Ryanair and Spirit Airlines in its two-star rating, which “signifies a poor standard of product and/or poor and inconsistent standards of staff service delivery in the onboard or airport environments” (*Skytrax*, n.d., para. 2). These results from the American Customer Satisfaction Index, *TripAdvisor*, and *Skytrax* indicate airline administrators are willing to sacrifice customer satisfaction for operating a no-frills airline and the profitability of these airlines indicate the most price-sensitive passengers are willing to sacrifice comfort, flexibility and in some cases, convenience, for saving money.

Administrators for low-cost carriers are increasingly faced with the dilemma of whether to base their competitive advantage solely on the lower price or have other factors that may positively impact customer relations. In the information age of today with airline incidents or accidents being a popular eye-catching breaking news heading in the mainstream media or with social media giving each and every passenger the power to catapult complaints onto the mainstream world stage, airline social and public relations teams are increasingly required to be able to quickly respond and defuse a potential problem before it spirals out of control (Capozzi & Rucci, 2013). One particular infamous example included the situation of passengers being stranded on a JetBlue Airways aircraft for 14 hours on the runway in New York’s John F. Kennedy International Airport in February of 2007, which was widely aired over mainstream and social media and required a rapid and aggressive response directly from JetBlue Chief Executive Officer David Neeleman (as cited in Capozzi & Rucci, 2013).

Another example involved a passenger who was deemed to be too large onboard a Southwest Airlines flight, in which the passenger in question was transferred to a later flight. This ignited a social media firestorm in which the communications team for Southwest Airlines



had initially become defensive and then apologetic (Capozzi & Rucci, 2013). This highlights the topic of seat width and the desire for airlines to seat as many passengers as possible within their aircraft with the trend of shrinking seat widths, with an industry average of only 17 inches of width for international flights (Ostrower & Michaels, 2013). Airline administrators need to determine if the lower fare outweighs such strategies of balancing the balance sheet and risk harming the reputation of the airline.

Another source of cost advantages, especially for a low-cost carrier is the economies of scale. This term is defined by Barney and Hesterly (2012) as lower costs that are associated with an increase in the size of a firm. Many airline administrators from both the cost leadership and product differentiation sectors of the airline industry market have used this approach with the mergers between United Airlines and Continental Airlines, Delta Air Lines and Northwest Airlines, and American Airlines and US Airways. The decision to use a uniform fleet is typical of low-cost carriers with 68% of 74 low-cost carriers around the world analyzed by Gross and Lück (2013) “use only one type of aircraft, while 26 [percent] use two types, and 8 [percent] use more than two different aircraft types” (p. 11). The Boeing 737 family of aircraft is the most popular aircraft among the low-cost carriers, followed closely by the Airbus A320 family, with a combined total of 65 out of the 74 analyzed carriers operating either the Boeing 737 or Airbus A320 (Gross & Lück, 2013). Using a uniform fleet, maintenance and training costs are reduced, fewer spare parts are required, and aircraft are more interchangeable should one aircraft be found out of service.

According to the American Customer Satisfaction Index, the customer satisfaction gap for travelers who pay for baggage fees versus those who do not have apparently closed, indicating that there is a general, but grudging acceptance of such ancillary fees as the new normal (ACSI,



2015a). With this new standard across the airline industry, airlines administrators for airlines such as Southwest Airlines would gain a slight competitive advantage from continuing to not charge baggage fees to their customers. Southwest Airlines has the added advantage of having non-allocated seats, therefore minimizing passenger boarding and seating confusion, additional revenue from passengers wishing to have priority boarding, and reducing time on the ground, where the aircraft does not make the airline administrators any money (Gross & Schröder, 2007; Pratley, 2003). Administrators for low-cost carriers prefer to avoid the integration of connections, even within their own airline network to “avoid endangering punctual arrivals and departures” (Gross & Schröder, 2007). However, there are options for passengers who wish to continue to use the practice known as *self-hubbing*, in which there are numerous Internet travel agency platforms such as *Kayak* or *Expedia* that can aid passengers in arranging connecting flights at their own risk. In minimizing the turnaround time for aircraft meaning that the time the aircraft is on the tarmac is shortened, the disadvantage relating to shorter flight durations with an average of 2.5 to 3 hours is compensated (Gross & Schröder, 2007, p. 39).

In today’s modern airline industry, traditional full-service airlines are presenting additional options to the traveling public in order to compete with the low-cost carriers by modifying their existing product by “eliminating or cutting down on service elements from the standard product’s profile , [such as] a switch to on-board sales of food and beverages [or making] lower ticket prices contingent on more restrictive booking options” (Gross & Schröder, 2007, p. 13). For example, Delta Air Lines has adopted a fare class known as Basic Economy with the most number of restrictions to passengers. Passengers under this rigid fare class can make neither “advance seat selection nor itinerary changes...not even for an extra fee”, which may deter families or couples wishing to sit together (Delta Air Lines, n.d.; Tuttle, 2014, para.



5). Additionally, passengers under this fare class are unable to make any cancellations, which would deter passengers who may have unexpected changes in their travel schedule (Delta Air Lines, n.d.; Tuttle, 2014, para. 5).

Administrators for other airlines such as Deutsche Lufthansa AG, or simply Lufthansa based out of Germany own a subsidiary known as Germanwings, which exists in the low-cost carrier market “offering a budget product” (Gross & Schröder, 2007, p. 14) in addition to offering a budget fare class known as Economy Basic in its parent airline, Lufthansa. This fare class was implemented after the addition of a premium economy section, which is the trend in many full-service airlines in which customers can pay extra in order to travel in more comfort without the high expense of flying in business or first class. The approach for Lufthansa for this fare class is to attract the price-sensitive travelers of Europe while attempting to maintain customer loyalty through its mainline carrier (Lufthansa AG, n.d.).

Airline administrators implementing a cost leadership business-level strategy are facing competition from not only other low-cost carriers, but also the traditional full-service airlines seeking to implement both a premium and a budget service. While administrators for low-cost carriers do not typically have the advantage of long-haul international flights, they have the advantage of scheduling multiple short-haul flights per day, minimizing turnaround time by configuring a uniform type of fleet and in many cases, such as with Southwest Airlines, have non-allocated seats to speed up the boarding process. Airline administrators for both low-cost carriers and full-service airlines respond to the increasing scrutiny from the traveling public, as consumers become smarter and more informed with online platforms and tools such as web search engines or social media platforms in which unhappy customers can easily announce their grievances to the world at large.



### **Shareholders and the U.S. Air Transport Industry**

The air transport industry in the United States is a major contributor to the national economy, improving productivity and creating over 11 million jobs in airlines and airports around the country. This industry has enabled global trade and passenger movement in a safe, economical, and efficient manner (Airlines for America, 2015). With a country as large as the United States, traveling by air is a faster and more efficient form of transportation than traveling by road or rail, making air travel more of a necessary activity rather than a luxury for long-distance trans-continental domestic or trans-oceanic long-haul travel.

An important element to note about the U.S. air transport industry is that cabotage is prohibited by U.S. law under United States Code Title 49, Section 41703(c) (*Navigation of foreign civil aircraft*, 2012). 49 U.S.C. Section 41703 states that foreign carriers may only fly between two points within the United States under a set of emergency circumstances as outlined in 49 U.S.C. Section 40109. This states that a foreign carrier can only operate between two points within the United States if there is an emergency that does not arise out of normal operating parameters and all efforts to accommodate traffic using U.S.-based carriers have been exhausted regardless of whether the U.S. carriers in question are charging excessive fares (U.S. Department of Transportation, 2011). From a customer perspective, this reduces the level of competition from foreign sources, which may result in higher fares, but this lack of foreign competition can be seen as a positive outlook for shareholders invested in the U.S.-based carriers due to the limits on foreign influence on domestic market share of flight routes.

As a service industry, customer satisfaction is one of the most important indicators of an airline's performance. Additionally, the air transport industry is also heavily influenced by the price fluctuations of crude oil due to the reliance on jet fuel for aircraft, as the costs for this fuel



make up as much as one-third of an airline's total expenses. These issues will be discussed in more detail in addition to an in-depth analysis of seven of the major carriers in the United States being Southwest Airlines, JetBlue Airways, Spirit Airlines, Alaska Airlines, American Airlines, Delta Air Lines, and United Airlines to compare and contrast elements of shareholder value among the carriers.

### Relationship between Customer Satisfaction and Shareholder Value

Table 1.

*ACSI customer satisfaction levels for U.S. based airlines.*

	Base line	05	06	07	08	09	10	11	12	13	14	15	Previous Year % Change	First Year % Change
<b>JetBlue</b>	NM	NM	NM	NM	NM	NM	NM	NM	81	83	79	81	2.5	0.0
<b>Southwest</b>	78	74	74	76	79	81	79	81	77	81	78	78	0.0	0.0
<b>Alaska</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	75	N/A	N/A
<b>Airlines</b>	<b>72</b>	<b>66</b>	<b>65</b>	<b>63</b>	<b>62</b>	<b>64</b>	<b>66</b>	<b>65</b>	<b>67</b>	<b>69</b>	<b>69</b>	<b>71</b>	<b>2.9</b>	<b>-1.4</b>
<b>Delta</b>	77	65	64	59	60	64	62	56	65	68	71	71	0.0	-7.8
<b>American</b>	70	64	62	60	62	60	63	63	64	65	66	66	0.0	-5.7
<b>Allegiant</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	65	N/A	N/A
<b>United</b>	71	61	63	56	56	56	60	61	62	62	60	60	0.0	-15.5
<b>Frontier</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	58	N/A	N/A
<b>Spirit</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	54	N/A	N/A
<b>Northwest Airlines</b>	69	64	61	61	57	57	61	#					N/A	N/A
<b>Continental</b>	67	70	67	69	62	68	71	64	#				N/A	N/A
<b>US Airways</b>	72	57	62	61	54	59	62	61	65	64	66	#	N/A	N/A

Source: Benchmarks by industry: Airlines by the American Customer Satisfaction Index (ACSI), Ann Arbor, MI: Author. <http://www.acsi.org>



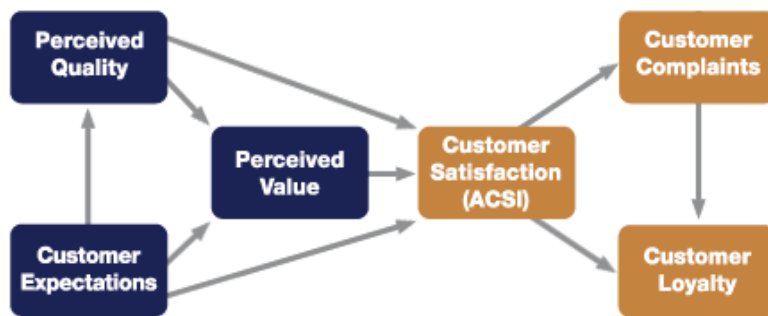
According to a test performed by Anderson, Fornell, and Mazvancheryl (2004) on “nearly 200 publicly traded Fortune 500 firms from 1994 to 1997,” (p. 172) there is a strong and positive relationship between customer satisfaction as portrayed by the American Customer Satisfaction Index (ACSI) and a measure known as *Tobin’s Q*. This *Tobin’s Q*, or Q-ratio is a measure that was developed by Nobel laureate James Tobin of Yale University. Tobin had hypothesized an “alternative to traditional financial measures of value by comparing the market value of an asset to its replacement cost” (Damodaran, 2012, p. 537). By improving customer satisfaction, this will reduce the volatility of the share price. This is attributed from a satisfied customer base and greater customer retention, which leads to a more predictable source of future cash flows and less volatility (Anderson, Fornell, & Mazvancheryl, 2004; Gruca & Rego, 2005). Another connection shows that there is a more rapid market penetration for companies with higher customer satisfaction numbers with a “ready market for new add-on services or product-line extensions” (Anderson et al., 2004, p. 173). With higher customer satisfaction, customer acquisition costs decline with positive word-of-mouth referrals and recommendations by customers in addition to having greater resistance against downward pressure on prices (Anderson et al., 2004).

A discounted cash flow model is one of the most accepted forms of a firm’s valuation, often used by chief financial officers (CFOs), who utilize an estimate of the individual cash flows, discount rate, and terminal value, all of which must be supported with reliable information from a company’s financial data (Larrabee & Voss, 2012; Ryan & Ryan, 2002). Using this model, there is a positive correlation between “the effects of customer satisfaction on customer behavior [resulting] in increased cash flow growth and acceleration as well as a reduction in cash



flow volatility” (Gruca & Rego, 2005, p. 115). These factors have a positive effect on shareholder value with the stability and increase of cash flows.

As depicted in Table 1, the American Customer Satisfaction Index (ACSI) ranks the airline satisfaction levels with the airline industry overall earning a score of 71 in 2015, which was a 2.9% increase from the value in 2014 (ACSI, 2015b). A visual representation of how the



*Figure 1.* Components of the drivers of customer satisfaction.

Source: About ACSI: The science of customer satisfaction, Ann Arbor, MI: Author.  
<http://www.acsi.org>

ACSI score is calculate is depicted in Table 1, where each of the determinants, being customer expectations, perceived quality and perceived value are weighted and then measured to produce the index score (ACSI, n.d.). This index, as translated back to customer satisfaction, is becoming increasingly important in the age of social media, where “customers can spread stories of happiness and unhappiness very quickly” (Sorensen, 2015, p. 13).

According to Sorensen (2015), there is a positive correlation between good customer service, utilizing the components of kindness and empathy, and increased revenue through ancillary sources. Sorensen (2015) defines empathy as understanding “another person’s condition from their perspective” (p. 4) while observing others and using interpersonal skills to determine what the person is thinking or feeling. This applies to empathy shown towards customer from the front-line employees in addition to the empathy and understanding shown to



the employees from management. There needs to be effective communication between upper-management executives and the front-line employees so that complexity is not added with the addition of additional *a-la-carte* products when current training and resource infrastructure are insufficient to sustain competent service (Sorensen, 2015). From another perspective, the lack of empathy can cause negative publicity, especially in an era of social media and empowered customers around the world. The United States Congress intervened in 1986 with the passage of the Air Carrier Access Act, which was in response to the U.S. Supreme Court ruling in favor of the airlines in continuing discriminatory behavior against disabled passengers (Sorensen, 2015; U.S. Department of Transportation, 2003). More recently, the Department of Transportation had to intervene in “protecting passengers from significant ground-based delays” (Sorensen, 2015, p.

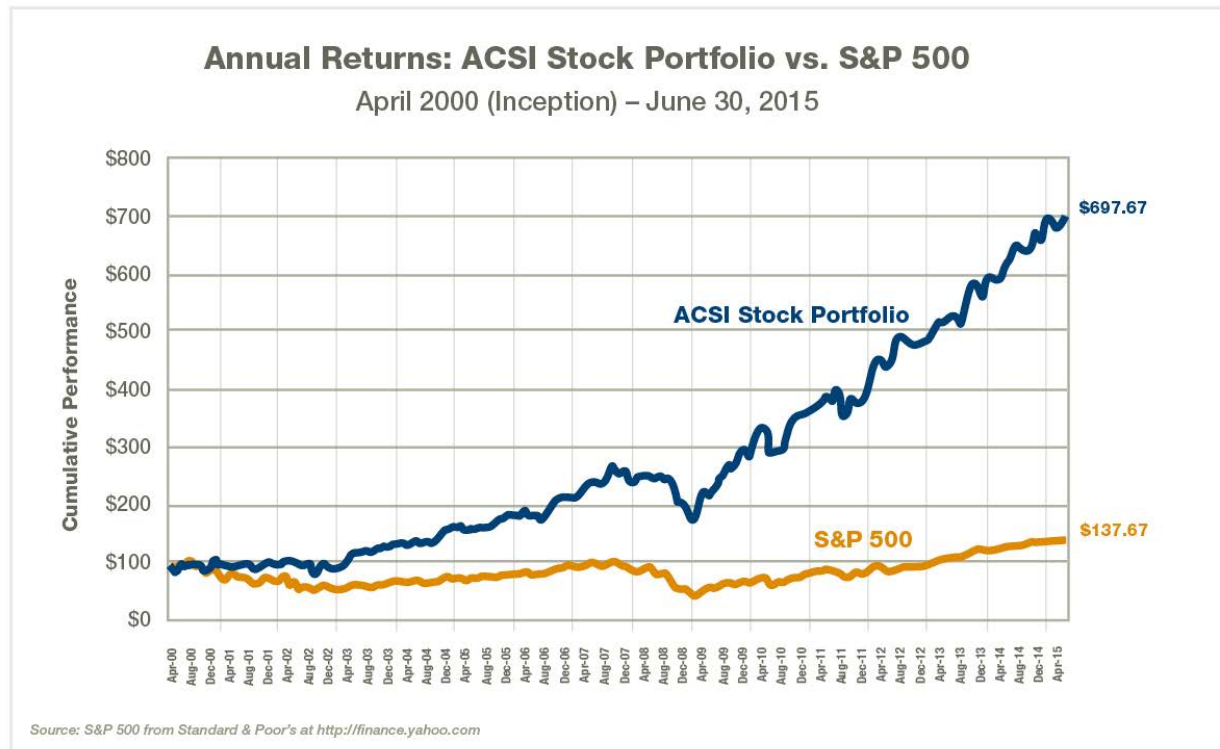


Figure 2. ACSI stock portfolio vs. S&P 500.

Source: The ACSI as financial indicator by the American Customer Satisfaction Index (ACSI). Ann Arbor, MI: Author.



8) with the final rule on Enhancing Airline Passenger Protections requiring an option to allow passengers to deplane after four hours on the tarmac, provided safety, security or ATC exceptions do not prohibit that from occurring (U.S. DOT: Office of Aviation Enforcement and Proceedings, 2015).

According to the ACSI stock portfolio as depicted in Figure 2, there is an obvious and positive correlation between customer satisfaction and the performance of the stock price and ultimately, shareholder value (ACSI, 2015c). The difference between the two grew more apparent after December of 2008, when the trend of the ACSI stock portfolio grew sharply in comparison to the S&P 500. With a service industry such as with the airlines, customer satisfaction has a much greater impact than products with longer purchasing cycles, especially with an increase in demand for air travel (Hart, 2007).

### **Relationship between Customer Satisfaction and Employee Satisfaction**

The relationship between the variables of customer satisfaction and employee satisfaction has been widely researched by managers and executives of companies big and small, and is often viewed as critical to those in the service industry. The relationship between these two variables has been noted to be enhanced by trust between the customer and contact employee, where the employee demonstrates an honest effort to assist the customer in his or her needs (Beatty, Mayer, Coleman, Reynolds, & Lee, 1996). When this is performed in conjunction with exceeding customer expectations in empathy, assurance, and responsiveness, a deeper social and emotional connection is made between the contact personnel and the customer, which is a major predictor for increased customer loyalty (Beatty et al., 1996). This creates reciprocal positive reinforcement and genuine appreciation from the customer, which in turn, is a source of



employee satisfaction if in fact the employee was genuine in providing quality service (Beatty et al., 1996; Jeon & Choi, 2012). A few examples of how airline contact personnel perform to retain the loyalty of the customers, are through the frequent flyer programs, periodic gifts of nominal value, and a dedicated service representative at the airport assigned individually to an airline's most valued customers to further increase the social and emotional connection between the employee and the customer. The latter of these examples is known as relationship selling, where specially trained employees are specifically assigned to one of the airline's top tier frequent flyer clientele or VIPs, which is rarely seen outside the realm of full-service airlines using the product differentiation approach in an effort to further customize the passenger experience (Beatty et al., 1996).

Employees, especially those in a contact personnel position must be sufficiently motivated and feel like a part of a cohesive and efficient team, in which they are sufficiently respected, rewarded, and recognized for their efforts in their company (Beatty et al., 1996). This applies greatly to those in the positions to work with VIP customers, where the traits of attentiveness, friendliness, empathy, and enthusiasm are especially important, which is demonstrated most often with satisfied employees (Beatty et al., 1996; Jeon & Choi, 2012). According to Beatty et al. (1996), it is important for companies to treat contact employees well, or face the negative effects of lost revenue and customers through any kind of relationship selling program. Employees have been shown to demonstrate reciprocity in providing quality service to the customers when they perceive that they are treated well and fairly, and that they have sufficient support from those in a leadership or supervisory role (Jeon & Choi, 2012). Schneider and Bowen (as cited in Jeon & Choi, 2012) highlighted that "employee job



satisfaction is positively related to customers' perception of service" (p. 333) which then improves employee retention and commitment towards the organization.

### Performance Indicators of the Airline Industry

#### Break-even Load Factor

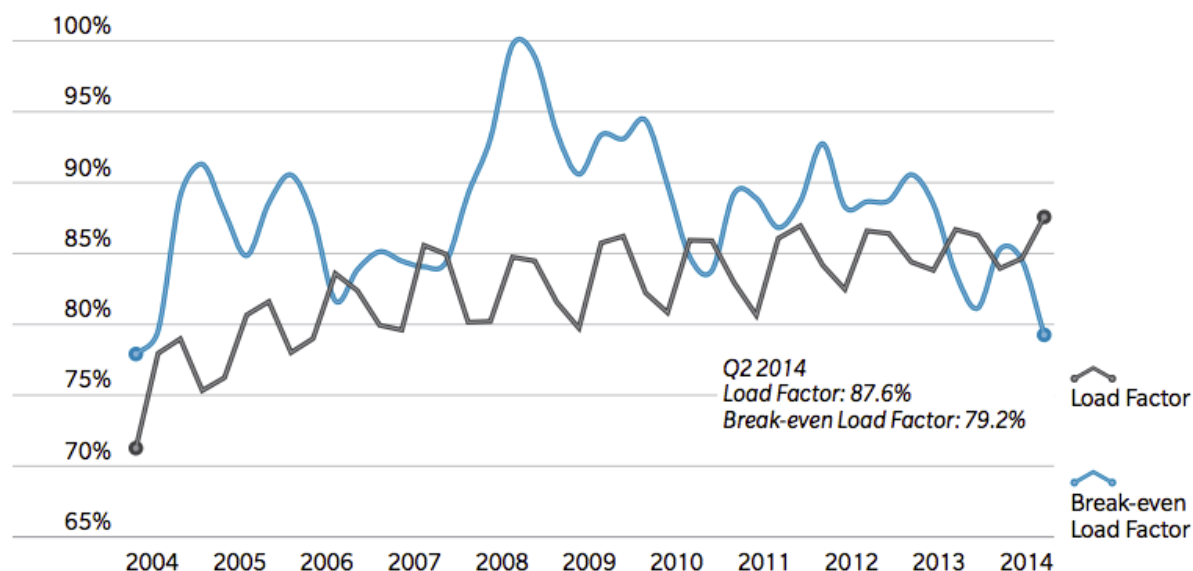


Figure 3. Load factor and break-even load factor for full-service airlines 2004-2014.

Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.

There are many indicators that are used in the airline industry to measure performance of the airline as a whole in terms of financial or overall standing, one of which is the break-even load factor. The break-even load factor is the “number of seats that must be sold for [full-service airlines] and [low-cost carriers] to break even” (Hazel, Stalnaker, Taylor, & Usman, 2014, p. 40). According to Hazel et al. (2014), the average load factor for domestic operations for the first and second quarter of 2014 was 85.6% while the load factor for 12 months ended July 2014 and July



2015 as reported by the Bureau of Transportation Statistics was 84.2% and 84.4%, respectively (U.S. DOT: Bureau of Transportation Statistics, 2015b).

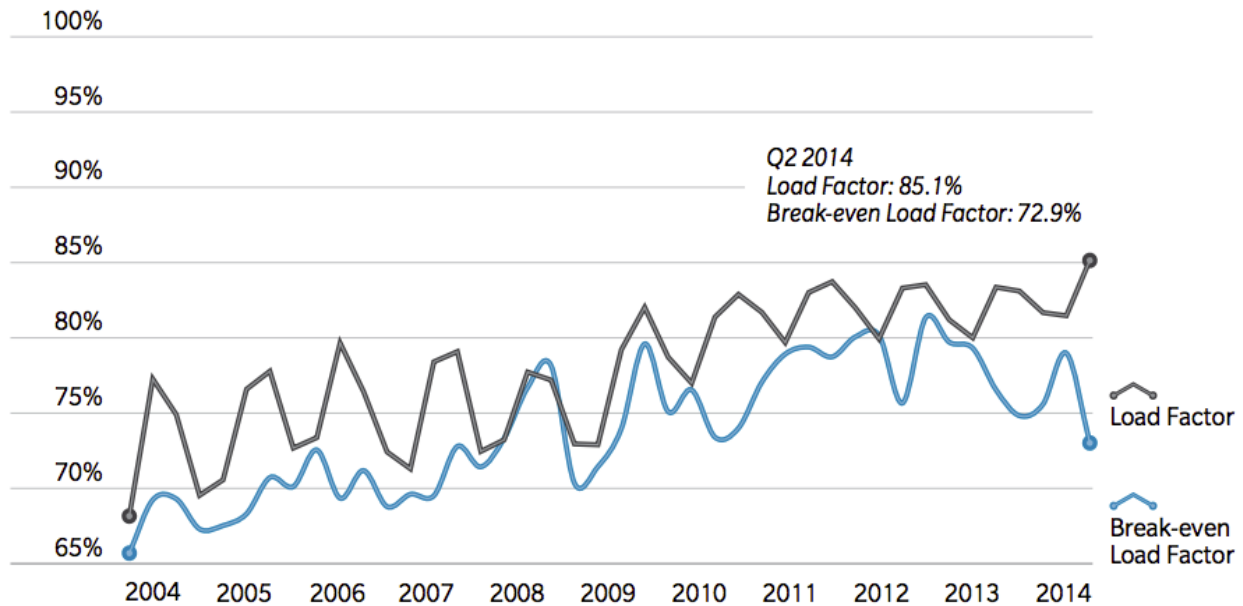


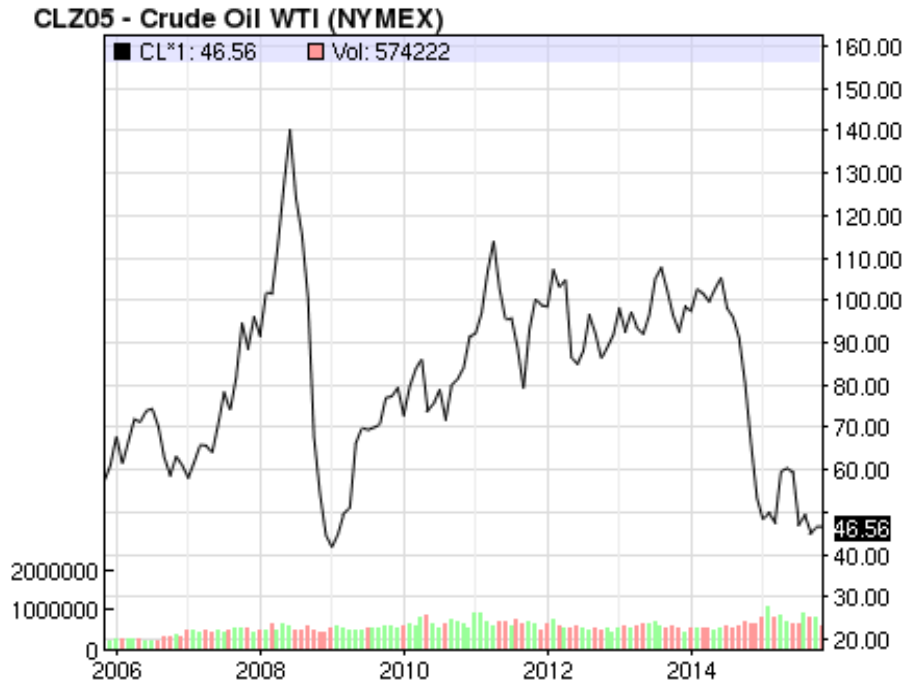
Figure 4. Load factor and break-even load factor for low-cost carriers 2004-2014.

Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.

According to Figures 3 and 4, which depict the comparisons between the load factor and the break-even load factor in full-service airlines and low-cost carriers, there has been a cyclical trend in the load factor as demand increases during certain segments of the calendar year, especially around holidays, in a term that is called “load factor seasonality” (Hazel et al., 2014, p. 42). While it is important to note that neither Figure 3 nor 4 take into account the ancillary revenues from the airlines, examining Figure 3 for the full-service airlines, there has not been much of a change in the peaks and troughs of the load factor. The break-even load factor for the full-service airlines, however, has been consistently above the load factor for the majority of the period from 2004 to 2014. Figure 3 in particular highlights the massive spike in the break-even



load factor due to the rise in crude oil prices in 2008 to over \$140 as shown in Figure 5 (Nasdaq Stock Exchange, 2015). To highlight the data also in Figure 4, there is a significantly different picture of the load factor being consistently higher than the break-even load factor for the 2004 to 2014 time period, except a spike in the break-even load factor in 2008 again due to the drastic



*Figure 5.* Historical price trend of crude oil, West Texas Intermediate (WTI) from 2006 to 2015 from the New York Mercantile Exchange (NYMEX).

Source: End of day commodity futures price quotes for crude oil WTI (NYMEX) by the Nasdaq Stock Exchange, New York: NY: Nasdaq.

increase in the price of crude oil. With both full-service and low-cost carriers, the dependence on aviation fuel, and ultimately crude oil is a major factor in operating costs, “comprising over 30% of airline operating costs, [which is] the largest airline cost component” (Hazel et al., 2014, p. 4). The more recent improvement in the margin between the load factor and the break-even load factor can be attributed to rising air fares and relatively flat costs from less fuel price volatility in 2014, showing a “standard deviation of the average jet fuel price [to be] only 4.0%



for the year ended June 2014, compared with 11.3% during the prior 12-month period” (Hazel et al., 2014, p. 11).

The data on the break-even load factor is broken down even further in Figure 6, which depicts a comparison of the carriers based in the United States in regards to their margin in between the respective airline’s load factor and the break-even load factor. As shown in Figure 6, it is clear that Spirit Airlines had the greatest gain in the second quarter of 2014, while United Airlines had the lowest.

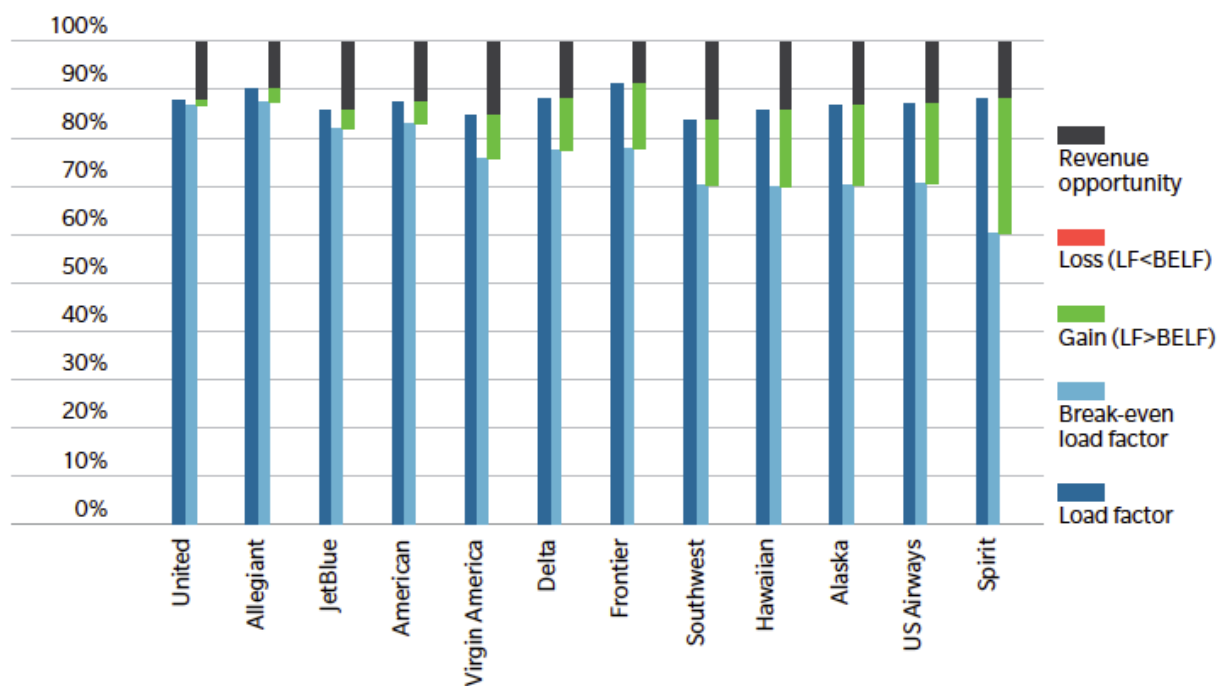


Figure 6. U.S. break-even load factor vs. load factor comparison (domestic) in 2014 Q2.

Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.



### Available Seat Miles (ASMs)

The term of available seat miles is a common indicator used in the airline industry to determine the number of seats that are available for sale on a particular flight multiplied by the number of miles flown for that particular flight segment. These seats that are available for sale are a revenue opportunity for airline administrators to achieve a goal of at least break-even on a certain flight to make a decision on whether or not to continue servicing a certain route between two city pairs. From a shareholder perspective, the available seat miles indicate which airlines have the best potential for generating large amounts of revenue. Naturally, the particular performance indicator favors the airlines operating under the revenue model rather than the cost model, which is catered more towards the full-service airlines using the product differentiation business-level strategy. According to Table 2, there has been steady growth in the number of

Table 2.

*Available seat miles for U.S. carriers 2010-2014.*

	Available Seat Miles (millions)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	165,420	167,828	166,223	168,340	
AA/US Airways (post-merger)				259,914	265,657
Delta Air Lines	232,684	234,656	230,415	232,740	239,676
UAL/Continental	169,565	252,528	248,860	245,354	246,021
Southwest	98,437	120,579	128,137	130,344	131,004
JetBlue	34,744	37,232	40,075	42,824	44,994
Alaska Airlines	27,736	29,627	31,428	33,672	36,078
Spirit Airlines	8,120	9,353	11,344	13,861	16,340

Source: Adapted from 10-K SEC filings from American Airlines, Delta Air Lines, United Airlines, Southwest Airlines, JetBlue Airways, and Alaska Airlines.



available seat miles comparing the values from 2010 to the values in 2014. The post-merger American Airlines had the greatest combination of seat availability and distance flown with over 265.6 billion available seat miles. It is interesting to note, however, that Alaska Airlines had the least number of available seat miles, despite operating as a full-service airline, because of its limited route structure in not offering trans-oceanic flights other than to Hawaii, and limited diversity in its fleet. A more in depth analysis into Alaska Airlines will be discussed later in this thesis.

### Revenue Passenger Miles (RPMs)

*Table 3.*

*Revenue passenger miles for U.S. carriers 2010-2014.*

	Revenue Passenger Miles (millions)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	134,298	136,386	136,620	138,878	
AA/US Airways (post-merger)				215,541	217,870
Delta Air Lines	193,169	192,767	192,974	194,988	202,925
UAL/Continental	140,857	207,531	205,485	205,167	205,559
Southwest	78,047	97,583	102,875	104,348	108,035
JetBlue	28,279	30,698	33,563	35,836	37,813
Alaska Airlines	22,841	25,032	27,007	28,833	30,718
Spirit Airlines	6,664	8,007	9,664	12,001	14,159

Source: Adapted from 10-K SEC filings from American Airlines, Delta Air Lines, United Airlines, Southwest Airlines, JetBlue Airways, and Alaska Airlines.

Another common performance indicator used in the air transport industry is known as revenue passenger miles (RPMs). This is an indicator that is often compared against the number of available seat miles as mentioned in the previous section. This is because the number of revenue passenger miles divided by the number of available seat miles gives the load factor, or in



layman's terms, what percentage of seats are filled in the airplane on average throughout the year. The revenue passenger miles (RPMs) is calculated by multiplying the number of revenue passengers, or paying customers, by the number of miles that are flown. Just like with the number of available seat miles, this is another performance metric that favors airlines that operate under the revenue model and have the economies of scale with a large and diverse fleet to operate a wide range of routes from short-haul domestic to long-haul international flights.

According to Table 3, post-merger American Airlines tops the list again in 2014 with over 217.8 billion revenue passenger miles, followed by United-Continental with over 205.5 billion RPMs and Delta Air Lines with over 202.9 billion RPMs. Alaska Airlines again ranks in revenue passenger miles in terms of the airlines targeted in this thesis. This is again because of its limited route structure in not providing trans-oceanic flights other than to Hawaii.

### **Cost per Available Seat Mile (CASM)**

Besides the available seat miles and the revenue passenger miles, the cost per available seat mile (CASM) is another common measurement used in the air transport industry. This is obtained by dividing the total operating costs of the airline in question by the number of available seat miles. Unlike the previous two performance indicators, this measurement favors airlines that focus more on a cost model and cost leadership business-level strategy rather than the revenue model or product differentiation approach. Also unlike the previous two indicators is that a lower number for the cost per available seat mile is more favorable for the airline in question as opposed to a higher number for the available seat miles or the revenue passenger miles. Naturally, the three low-cost carriers measured in Table 4 have the lowest cost per available seat mile with a cost of just over 14 cents per available seat mile for Southwest



Airlines, just under 13 cents for JetBlue Airways and a little over 9 cents per available seat mile for Spirit Airlines. It is important to note that although this exemplifies the effort of low-cost carriers in using the cost leadership business-level strategy to gain a competitive advantage, this does not suggest that the full-service airlines adopting a product differentiation approach do not care about their costs. Ultimately, the higher the cost of operating the flights, the less income there is for the company, and also the less return on value there is for the shareholder.

Table 4.

*Cost per available seat mile for U.S. carriers 2010-2014.*

	CASM (Cost per available seat mile)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	\$0.1340	\$0.1429	\$0.1495		
AA/US Airways (post-merger)				\$0.1589	\$0.1605
Delta Air Lines	\$0.1365	\$0.1496	\$0.1591	\$0.1623	\$0.1684
UAL/Continental	\$0.1376	\$0.1470	\$0.1493	\$0.1560	\$0.1581
Southwest	\$0.1230	\$0.1299	\$0.1334	\$0.1356	\$0.1420
JetBlue	\$0.1088	\$0.1210	\$0.1243	\$0.1271	\$0.1293
Alaska Airlines	\$0.1382	\$0.1457	\$0.1482	\$0.1531	\$0.1488
Spirit Airlines	\$0.0877	\$0.0991	\$0.1009	\$0.0990	\$0.0965

Source: Adapted from 10-K SEC filings from American Airlines, Delta Air Lines, United Airlines, Southwest Airlines, JetBlue Airways, and Alaska Airlines.



### Shareholder Value for Low-Cost Carriers in the United States

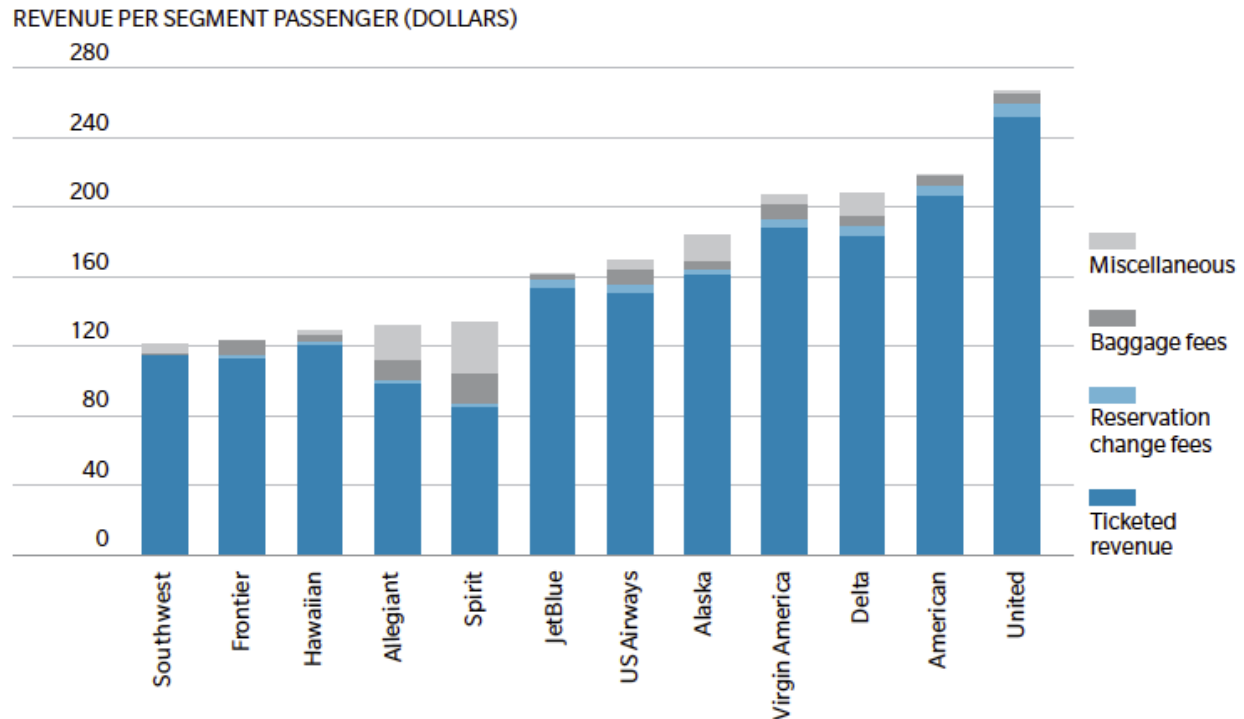


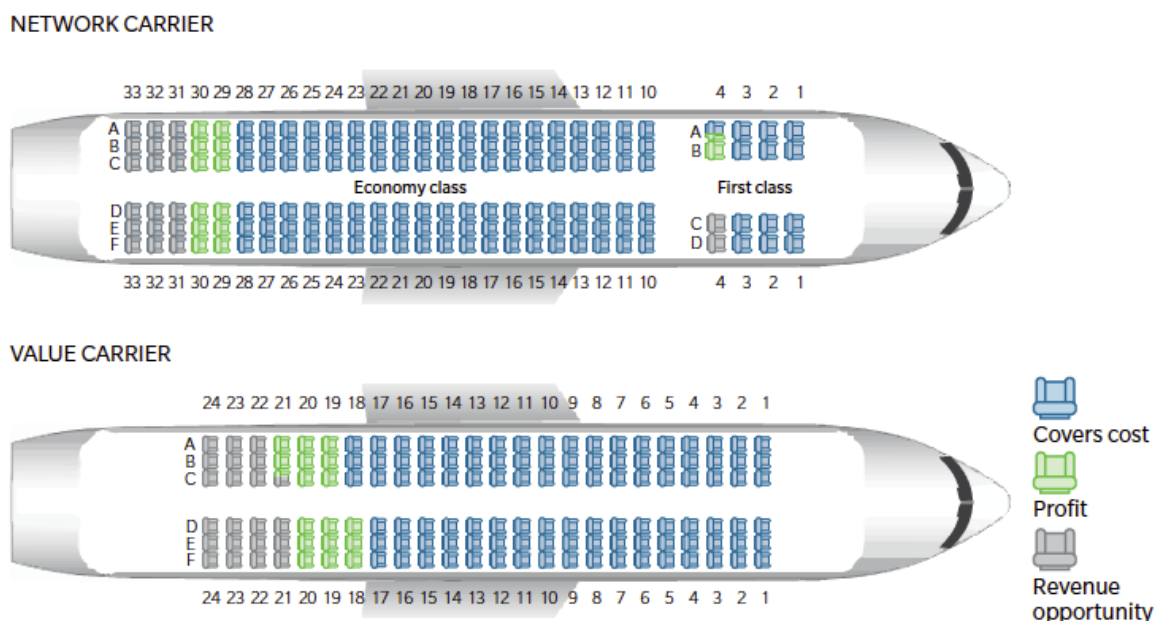
Figure 7. Comparison of categories of revenue per segment passenger for U.S. carriers.

Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.

Low-cost carriers (LCCs) attract the price sensitive traveler who value low prices over a better overall travel experience. LCCs in the United States include Southwest Airlines, Spirit Airlines, and JetBlue Airways. These carriers adopt a cost leadership approach to reduce the operational costs of the airline in order to provide cheaper fares to the passengers. Elements of service quality as noted by Leong et al. (2015) include tangibles, reliability, responsiveness, assurance, and empathy. With a strictly low-cost carrier offering low fares by adopting the cost leadership strategy, it is not reasonable to expect some differentiated premium-level tangibles in the form of business or first class cabins or dedicated VIP airport lounges.



Within the low-cost carriers, there exists the ultra-low cost carriers such as Spirit Airlines and Allegiant. Unlike Southwest Airlines or JetBlue Airways, Spirit Airlines and Allegiant obtain much of their revenue from ancillary sources due to the small profit margins for the airline seat, as these carriers try to capture the most price-sensitive travelers. As shown in Figure 7, Spirit Airlines had the largest percentage of revenue compared to the other carriers attributed to ancillary revenues, being 36.2% and including ancillaries such as reservation change fees, baggage fees, or miscellaneous fees. Miscellaneous fees are a broad category that include a-la-



*Figure 8.* Seats needed to be sold to break-even and revenue potential for network carriers (full-service airlines) and value carriers (low-cost carriers).

Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.

carte on-board meals, on-board wireless internet, priority boarding, in-flight entertainment, pillows, blankets, and in some cases, credit card and boarding pass printing fees (Hazel et al., 2014). The latter two fees are attributed more towards the ultra-low cost carriers Spirit and



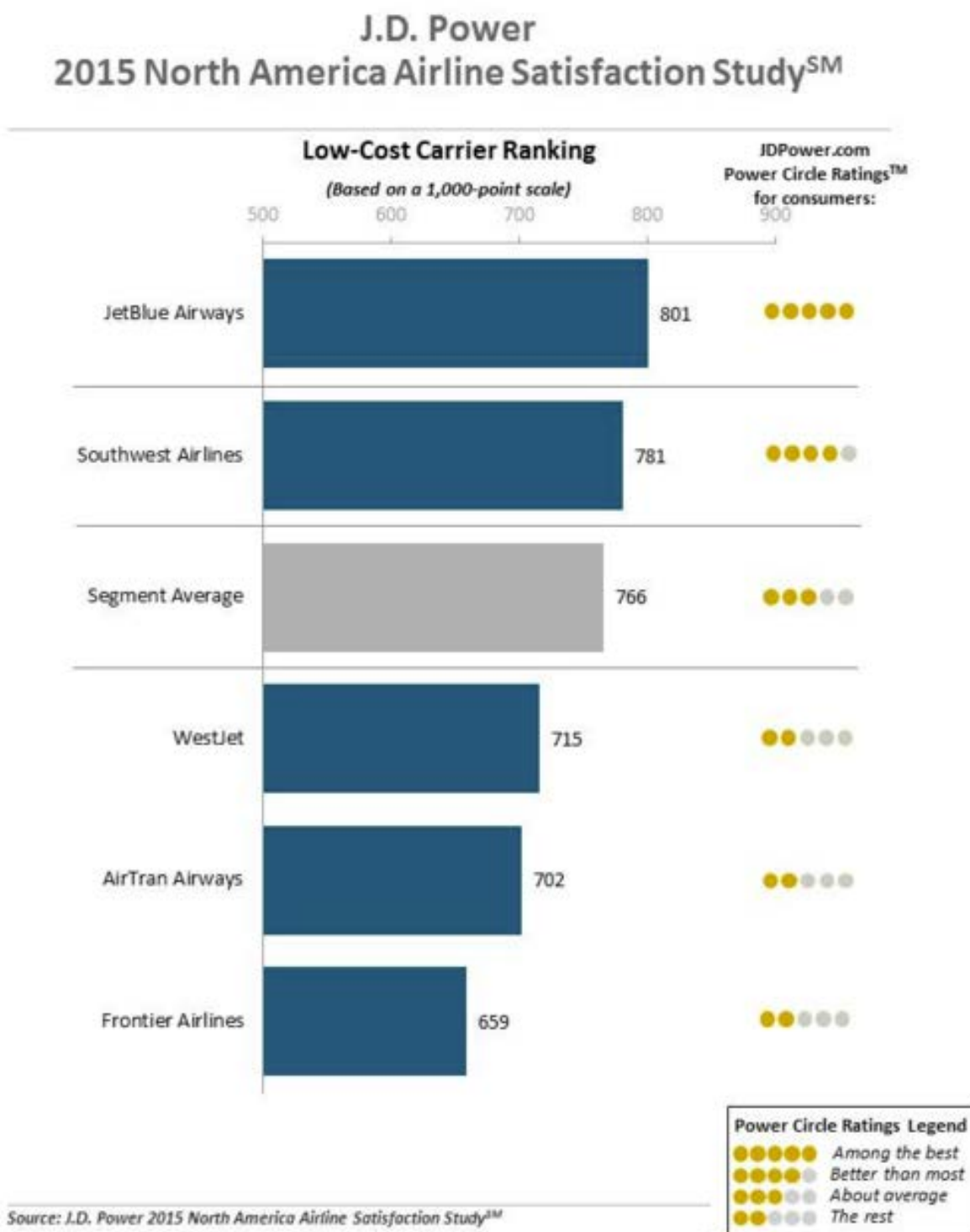


Figure 9. 2015 North America airline satisfaction study: Low-cost carrier rankings.

Source: <http://www.jdpower.com/press-releases/2015-north-america-airline-satisfaction-study>

Allegiant, the latter of which, Allegiant, pocketed 24.2% of its revenue or an average of \$45.23



per passenger from ancillary fees (Hazel et al., 2014).

Figure 8 depicts the number of seats that must be sold for both the low-cost carriers and full-service airlines to break even. The illustration in Figure 8 assumes the same break-even load factor for all classes of service and “any differences between actual and break-even passenger levels are distributed between the two cabins in proportion to the number of seats in each” (Hazel et al., 2014, p. 40).

### **Southwest Airlines**

Southwest Airlines (“Southwest”) is a low-cost carrier is based out of Dallas Love Field in Dallas, Texas and is led by Chief Executive Officer Gary Kelly. Through its mission of excelling in “customer service delivered with a sense of warmth, friendliness, individual pride, and company spirit” (“About Southwest,,” 2015, para. 1), Southwest’s airline administrators deliver shareholder value. This dedication to service instilled through the company mission is highlighted in the customer satisfaction rankings for both J.D. Power and the American Customer Satisfaction Index (ACSI). According to ACSI, Southwest has a score of 78, which is only second from JetBlue Airways and higher than all of the full-service airlines based in the United States (ACSI, 2015b). This same ranking is reflected through J.D. Power as indicated in Figure 9, with Southwest Airlines again ranked second behind JetBlue Airways with a score of 781 out of 1,000 and a J.D. Power Circle Rating of ‘better than most’ in terms of the low-cost carriers (J.D. Power, 2015a).

With the help of Southwest’s reputation for its low air ticket fares and strong passenger travel demand, airline administrators reported an earnings per share of \$1.03 during the June 2015 period (Henigson, 2015d). This amounted to \$691 million in earnings, making it the



highest in Southwest's 48-year history (Henigson, 2015d). According to the United States Department of Transportation's Bureau of Transportation Statistics (2015a), airline administrators for Southwest earned \$108.9 billion in revenue passenger miles domestically for 12 months ending in July 2015, which was an increase from \$95.67 billion for 12 months ending in July 2014. This was in addition to a market share of 17.8%, which again, was an increase from the 2014 figure of 16.3% (U.S. DOT: Bureau of Transportation Statistics, 2015a, 2015b).

Southwest has shown growth in the number of passengers carried and the total number of

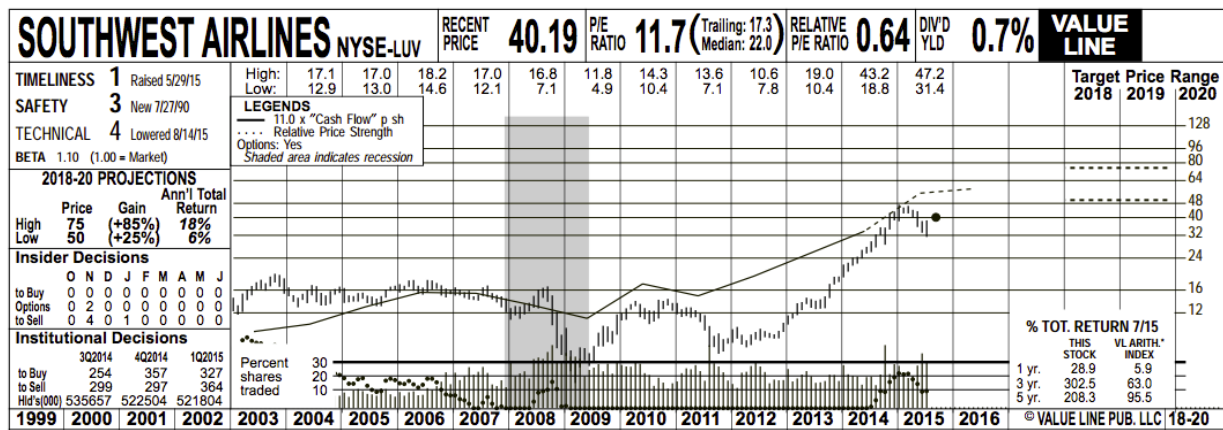


Figure 10. Southwest Airlines Value Line report (August 2015).

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>

departures from 2014 to 2015 being 121 million to 135.9 million passengers and 1.1 million to 1.2 million departures, respectively (U.S. DOT: Bureau of Transportation Statistics, 2015a).

Southwest Airlines operates only variants of the Boeing 737 family of aircraft to improve operational efficiencies. Southwest's airline administrators have placed orders for the new Boeing 737 MAX aircraft and the Boeing Next-Generation 737 aircraft to optimize the operating performance and reduce operating costs in an effort to modernize their fleet (Southwest Airlines, 2014). In relation to the Boeing 737 MAX in particular, the new aircraft offers 8% lower



operating costs, 1.8% less fuel consumption, lower airframe maintenance costs, and 300 to 500 more nautical miles of range than its closest competitor (The Boeing Company, 2015). From a shareholder perspective, these lower operating costs have the opportunity to increase the net profit of the airline and the longer range of the aircraft opens up the possibility of Southwest's airline administrators to create new routes to more locations, while increasing market share, especially with a planned growth in the total fleet by 2 percent in 2016 (PR Newswire, 2015). A meeting held by the Board of Directors for Southwest Airlines determined an increase in the quarterly dividends by 25% and authorized a \$1.5 billion share re-purchase initiative (PR Newswire, 2015). In terms of risk, Southwest Airlines has the highest rating out of the U.S. based airlines examined in this thesis, with a rating of BBB by Standard and Poor's (Standard and Poor's, 2015c). This rating by S&P demonstrates that Southwest has "adequate protection parameters [but] adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of [Southwest] to meet its financial commitment" (Standard and Poor's, 2014, para. 9) compared to S&P's AAA, AA, or A-ratings. This would be the case for any airline, due to the industry's reliance on aviation fuel and the sometimes-volatile nature of the prices of crude oil. However, this effect was dampened by the improvement of the fuel efficiency of Southwest's operations and aircraft with the use of ground power at airports, the control of aircraft ground idle speeds, equipping pilots with tablets in place of paper charts and manuals, and the installation of winglets on 39 of their Boeing 737-800 aircraft (Southwest Airlines, n.d.). According to the Value Line Investment Survey, Southwest Airlines, as depicted in Figure 10 has a safety rank of 3 on a scale of 1 through 5 with 1 being the least risky and most stable investments, while 5 represents the riskiest investments (Henigson, 2015d). This places Southwest in the average risk category, which is measured relative to approximately 1,700 other



stocks (Henigson, 2015d; Value Line Research Center, 2015). Southwest's timeliness of 1 ranks it in the top 100 stocks in terms of relative price performance in the upcoming six to twelve months while the technical rank of 4 indicates a below average short-term, 3-6 month price return in the same ranking of 1 through 5 (Henigson, 2015d; Value Line Research Center, 2015). With a price-to-earnings (P/E) ratio of 11.7, it means that shareholders are willing to pay \$11.70 for every dollar of Southwest Airlines' earnings. Southwest Airlines also highlights a dividend yield of 0.7% as indicated in Figure 10, which is the amount that Southwest Airlines would pay annually in dividends relative to its price per share of \$40.19. The price-to-earnings ratio and the fact that Southwest Airlines' administrators are paying out dividends places Southwest at an advantage from a shareholder perspective.

## Spirit Airlines

Spirit Airlines is an ultra-low cost carrier that is based out of Miramar, Florida, that adopts a strict cost leadership business-level strategy that attracts the ultra price-sensitive travelers. This demographic of passengers that Spirit Airlines administrators are trying to attract are those that are looking to simply travel from their point of origin to their destination for the

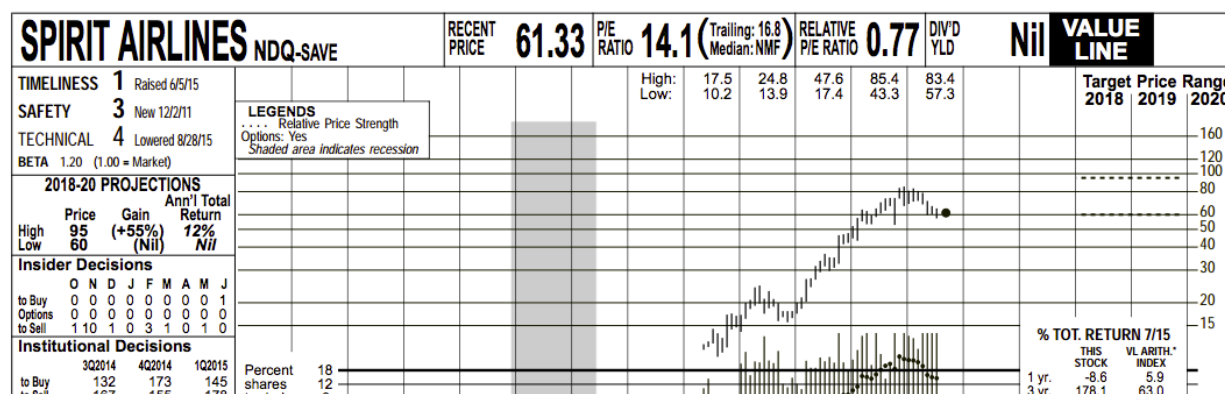


Figure 11. Spirit Airlines Value Line report (August 2015).

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>



Table 5.

*Spirit Airlines financial data.*

	Year Ended December 31,				
	2014	2013	2012	2011	2010 (1)
	(in thousands, except share and per share data)				
Operating revenues:					
Passenger	\$ 1,144,972	\$ 986,018	\$ 782,792	\$ 689,650	\$ 537,969
Non-ticket	786,608	668,367	535,596	381,536	243,296
<b>Total operating revenue</b>	<b>1,931,580</b>	<b>1,654,385</b>	<b>1,318,388</b>	<b>1,071,186</b>	<b>781,265</b>
Operating expenses:					
Aircraft fuel (2)	612,909	551,746	471,763	388,046	248,206
Salaries, wages and benefits	313,988	262,150	218,919	181,742	156,443
Aircraft rent	195,827	169,737	143,572	116,485	101,345
Landing fees and other rents	105,115	83,604	68,368	52,794	48,118
Distribution	74,823	67,481	56,668	51,349	41,179
Maintenance, materials and repairs	73,956	60,143	49,460	34,017	27,035
Depreciation and amortization	46,971	31,947	15,256	7,760	5,620
Other operating	149,675	144,586	127,886	91,172	83,748
Loss on disposal of assets	3,008	525	956	255	77
Special charges (credits) (3)	45	174	(8,450)	3,184	621
<b>Total operating expenses</b>	<b>1,576,317</b>	<b>1,372,093</b>	<b>1,144,398</b>	<b>926,804</b>	<b>712,392</b>
<b>Operating income</b>	<b>355,263</b>	<b>282,292</b>	<b>173,990</b>	<b>144,382</b>	<b>68,873</b>
Other expense (income):					
Interest expense (4)	2,747	214	1,350	24,781	50,313
Capitalized interest (5)	(2,747)	(214)	(1,350)	(2,890)	(1,491)
Interest income	(336)	(401)	(925)	(575)	(328)
Other expense	2,605	283	331	235	194
Total other expense (income)	2,269	(118)	(594)	21,551	48,688
Income before income taxes	352,994	282,410	174,584	122,831	20,185
Provision (benefit) for income taxes (6)	127,530	105,492	66,124	46,383	(52,296)
<b>Net income</b>	<b>\$ 225,464</b>	<b>\$ 176,918</b>	<b>\$ 108,460</b>	<b>\$ 76,448</b>	<b>\$ 72,481</b>
Earnings Per Share:					
Basic	\$ 3.10	\$ 2.44	\$ 1.50	\$ 1.44	\$ 2.77
Diluted	\$ 3.08	\$ 2.42	\$ 1.49	\$ 1.43	\$ 2.72
Weighted average shares outstanding:					
Basic	72,738,961	72,592,765	72,385,574	53,240,898	26,183,772
Diluted	73,293,869	72,999,221	72,590,574	53,515,348	26,689,855

Source: Form 10-K: Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 by Spirit Airlines. Miramar, FL: Author.

lowest possible unbundled fare (Spirit Airlines, 2014). As is common with low cost carriers, Spirit Airlines has a fleet composed of only Airbus A320 aircraft with common flight crews to reduce the operational costs from training, maintenance, and inventory. According to the American Customer Satisfaction Index (ACSI) scores depicted in Table 1, Spirit Airlines ranked last with a score of only 54. Despite efforts for Spirit Airlines' administrators, it would seem



that the customer expectations do not align with the perceived quality and value that the airline administrators are trying to offer. Administrators for Spirit Airlines obtain much of their revenue from ancillary sources as shown in Table 5 under non-ticket operating revenues. In an industry where customers expect lower ticket prices, causing lower profit margins for the basic airline seat, non-ticket revenue, as in the case of Spirit Airlines, have contributed between 40 and 41 percent between the years of 2012 and 2014, which was up from 35.6% in 2011 and 31.14% in 2010 (Spirit Airlines, 2014). From an October 2015 report issued by Spirit Airlines, “adjusted net income for the third quarter [of] 2015 increased 31.6 percent to \$97.3 million (\$1.35 per diluted share) compared to the third quarter [of] 2014” (Spirit Airlines, 2015, para. 1). In addition to the increase in net income, administrators for Spirit Airlines have also reported an increase in cash and cash equivalents, measured in a nine-month period from January to September of 2014 and 2015, from \$588,474 to \$748,896 (Spirit Airlines, 2015). These figures signify growth in the airline, which is attractive to shareholders because it increases the value of the shares in addition to the increase in cash assets increases the safety margin in terms of being able to pay off the airline’s short-term debt obligations.

According to the financial data depicted in Figure 11, Spirit Airlines has the same level of risk as shown in the safety ranking, as Southwest Airlines, with an average risk score of 3 on a scale of 1 through 5 (Henigson, 2015e). Spirit Airlines, additionally has the same timeliness rank as Southwest Airlines, being in the top 100 of stocks measured by the Value Line Research Center as having the best relative performance within six to twelve months. Also shown in Figure 11 is the price-to-earnings ratio of 14.1, meaning that investors are willing to spend \$14.10 for every dollar of earnings that is made by Spirit Airlines. The fact that Spirit Airlines does not pay out dividends places the ultra-low cost airline at a slight disadvantage from a



shareholder investment point of view, but the money that would have otherwise gone to the shareholder would have been reinvested back into the airline to help with growth and expansion.

### JetBlue Airways

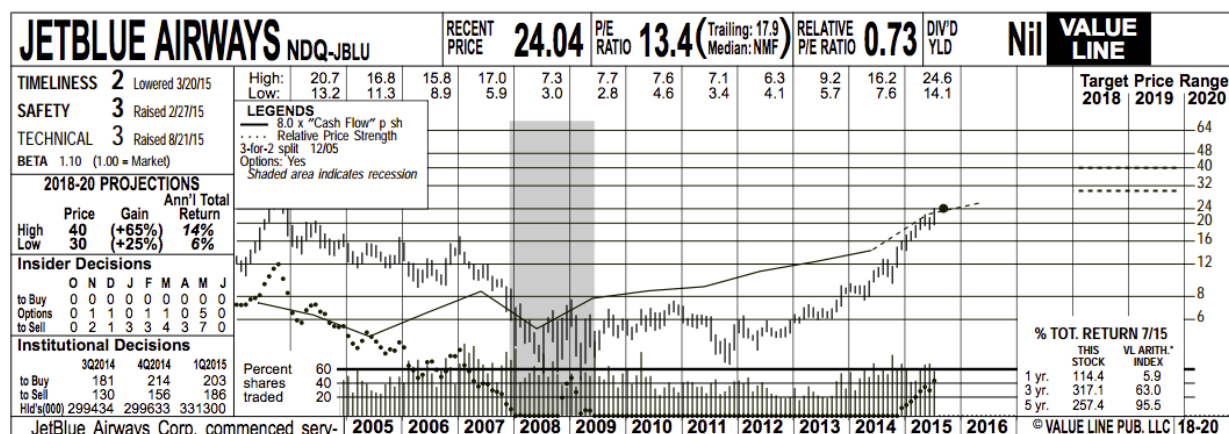


Figure 12. JetBlue Airways Value Line report.

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>

JetBlue Airways (JetBlue) is a low-cost carrier that is adopting a hybrid model of both the cost leadership and product differentiation business-level strategies. JetBlue Airways is based out of New York City, operates a fleet of Airbus A320, A321, and Embraer 190 aircraft, and operates flights domestically, Latin America and to destinations in the Caribbean (JetBlue Airways, 2014a). Unlike an ultra-low cost carrier, JetBlue offers free in-flight entertainment, snacks, and non-alcoholic beverages within its core service, while still offering additional products, services and amenities at an extra charge, for expedited security, alcoholic beverages, and JetBlue's *EvenMore™ Space* seats (JetBlue Airways, 2014a). JetBlue ranks first among all airlines measured by the American Customer Satisfaction Index (ACSI), with a score of 81 as shown in Table 1.



According to an investor update issued by JetBlue Airways, airline administrators have announced new routes between city pairs, to begin in the first and second quarters of 2016, and to include international routes from Fort Lauderdale to Quito, Ecuador and Barbados (JetBlue Airways, 2015). Additionally, airline administrators are looking to attract both leisure and

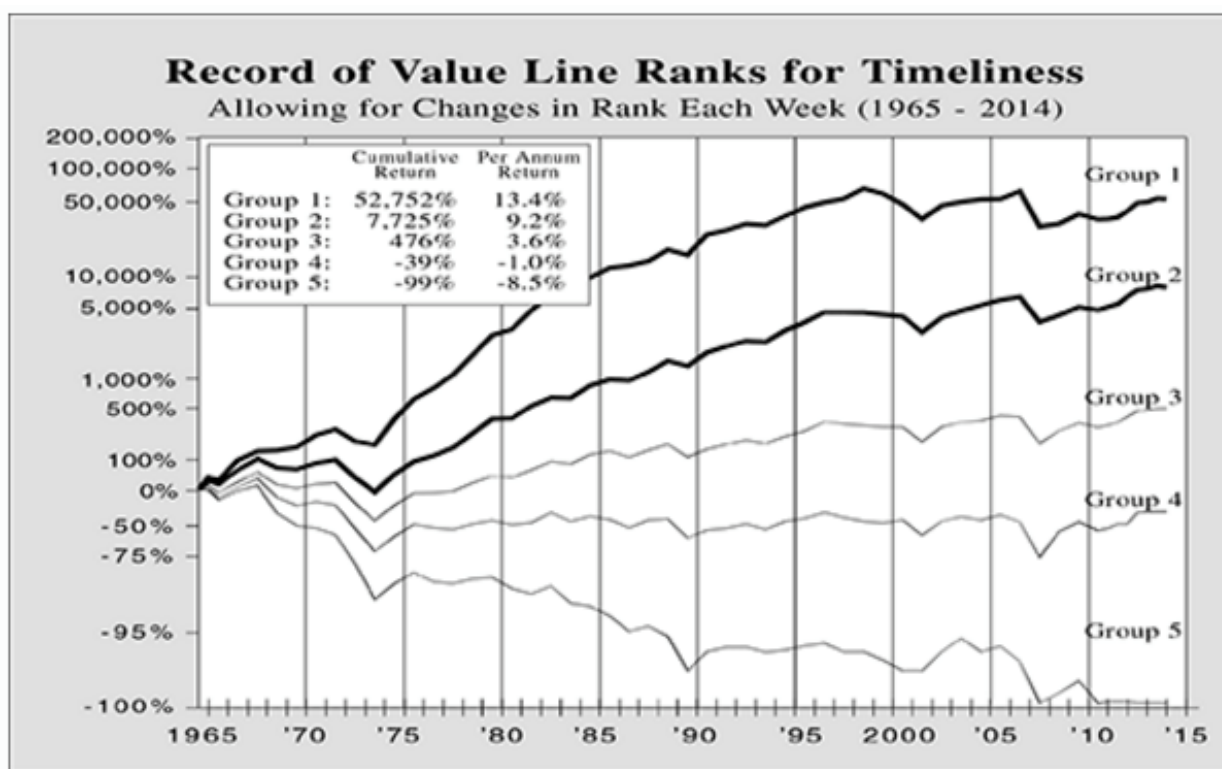


Figure 13. Value Line annual returns per timeliness rankings.

Source: The Value Line ranking system by the Value Line Investment Center.  
<http://www.valueline.com>

business travelers with an average current seat pitch of 34.7 inches across its fleet, a frequent flyer rewards program known as TrueBlue, and a premium class cabin for trans-continental flights known as *Mint* (JetBlue Airways, 2014b). This ‘customer sweet spot’ is between high value leisure customers and those with mixed wallets, a midpoint between the ultra-price sensitive and the road warriors, where in attracting the less price-sensitive customers, JetBlue Airways administrators can earn a greater amount of revenue per departure for transcontinental



flights such as from John F. Kennedy International Airport (JFK) in New York to Los Angeles International Airport (JetBlue Airways, 2014b). Airline administrators are also taking advantage of newer fuel efficient aircraft to reduce reliance and costs on aircraft fuel. The new Airbus A321neo aircraft that will be implemented in between 2018 and 2021 boasts 17-19% greater fuel efficiency than the current A320 aircraft in JetBlue Airways' fleet (JetBlue Airways, 2014b).

According to Figure 12, JetBlue Airways shares the same Value Line safety ranking as Southwest and Spirit Airlines, placing all of the low-cost carriers researched in this thesis in the average risk category from an investment perspective (Henigson, 2015c). In a slight contrast, the Standard and Poor's rating agency rated JetBlue Airways with a ranking of B+, which was an upgrade from a rating B in May of 2015 (Snyder & Baggaley, 2015). This rating was upgraded due to the increased stability of JetBlue Airways' financial outlook with a reduction in debt and improved operating performance (Snyder & Baggaley, 2015). A further upgrade in the rating is possible if the funds-from-operations (FFO) to debt ratio reaches a sustainable 40% by airline administrators continuing to reduce the amount of debt (Snyder & Baggaley, 2015). According to Standard and Poor's, the B+ rating informs investors that the company currently has the ability to fulfill its financial commitments, but negative business, economic, or financial conditions will likely impair that ability to fulfill those obligations (Standard and Poor's, 2014). Unlike the previous two airlines, however, JetBlue has a timeliness ranking of 2, which still remains a better-than-average ranking compared to 1,700 other stocks measured by the Value Line Research Center. Figure 13 depicts both the cumulative and per annum return for each timeliness ranking group, which shows that the stocks that are ranked in Group 1 have the greatest per annum return of 13.4%, followed by a distant 9.2% for stocks ranked in Group 2.



### **Shareholder Value for Full-Service Airlines in the United States**

Full-service airlines adopt a product differentiation approach to gain a competitive advantage in the dynamic airline transport industry. Some of the U.S. airlines adopting this approach include Delta Air Lines, American Airlines, United Airlines, and Alaska Airlines. These airlines, through their product differentiation business-level strategy, cater to the traveling public who value the travel experience more than simply traveling from the point of origin to the destination at the cheapest possible fare. From an overall business-level strategy perspective, tangibles make up one of the primary elements of customer satisfaction that would set a full-service airline apart from a low-cost carrier to the less price-sensitive traveler. Tangibles is defined as “the appearance of physical facilities, equipment, personnel and communication materials” (p. 6623) that would apply to the design and layout of the onboard cabins and airport lounges, and would have a “significant and positive influence on customer satisfaction” (Leong et al., 2015, p. 6623). According to Babbar and Koufteros (2008), the service provided by the front-line or contact employees, from the perspective and experience the customer has about the airline. With a full-service airline looking to differentiate itself from the competition with the quality of the product, the contact employees need to demonstrate “individual attention, helpfulness, courtesy, and promptness embedded in the element of personal touch” (Babbar & Koufteros, 2008, p. 824) to enhance customer satisfaction.





Figure 14. 2015 North America airline satisfaction study.

Source: <http://www.jdpower.com/press-releases/2015-north-america-airline-satisfaction-study>



## Delta Air Lines



Figure 15. Delta Air Lines Value Line report.

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>

Delta Air Lines (Delta) is a full-service airline headquartered in Atlanta, Georgia, operating a wide range of domestic and international flights out of one of its main hubs in cities such as Atlanta, New York, Detroit, Boston, Amsterdam, Paris, and Tokyo to name a few. As a full-service airline operating a product differentiation business-level strategy, Delta operates a hub and gateway network while also being a member of the *SkyTeam* global airline alliance (Delta Air Lines, 2014). Administrators for Delta Air Lines are leveraging the scale of its domestic and international network to provide better revenue efficiency and by establishing greater consolidation, Delta can increase revenues by approximately 20% on “20% fewer departures, 6% fewer seats, and 12% fewer aircraft since the merger [with Northwest Airlines]” (Delta Air Lines, 2015, p. 3).

Comparing a 12-month period ending in the second quarter of 2014 and 2015, the return on investment capital (ROIC) increased from 18.2% to 23.5%, and the operating cash flow increased 18% from \$5.4 billion to \$6.3 billion for the same measured time period (Delta Air Lines, 2015). Administrators for Delta Air Lines have also authorized a new \$5 billion



repurchase program through 2017 to return cash back to the shareholders, which provides shareholder value. In this initiative, Delta has returned “over \$3 billion in less than two years [and] will [continue to] return at least 50% of free cash flow to shareholders” (Delta Air Lines, 2015, p. 11). The adjusted net debt for Delta Air Lines for 2013 and 2014 was \$9.4 billion and \$7.3 billion, respectively, which represents and highlights Delta’s administrator’s attempts to lower the airline’s net debt to \$4 billion (Delta Air Lines, 2015). This increases the stability and lowers the financial risk for the company in its ability to fulfill its debt obligations. This is also in light of a an upgrade in Delta Air Lines’ rating by the credit rating agency, Standard and Poor’s (S&P), to BB+ (Caminiti, 2015; Standard and Poor’s, 2014). This new rating for Delta Air Lines was upgraded to only one level below investment grade because of the airline’s “strong earnings and cash flow...[allowing] Delta to significantly pay down its debt, while returning cash to shareholders via dividend payouts and share buybacks” (Caminiti, 2015, para. 3). In comparison, the safety ranking of Delta Air Lines according to the Value Line Research Center according to Figure 15 placed the airline in the average category among 1,700 stocks that were measured. However, Delta Air Lines earned a timeliness rating of 1, placing the airline in the top 100 stocks as compared with the same 1,700 stocks (Downing, 2015a).

In terms of customer satisfaction, according to Table 1, Delta earned an ACSI score of 71 which was equal to the airline industry average, which was the second highest out of the full-service airlines. To support this ranking, J.D. Power’s ranking perspective as illustrated in Figure 14 showed that Delta Air Lines was ranked as second among the full-service airlines, or traditional carriers with a score of 709 compared to Alaska Airlines’ score of 719. According to the Power Circle rankings also illustrated in Figure 14, Delta earned a ranking of ‘better than most’ among the North America-based airlines (J.D. Power, 2015b).



## American Airlines

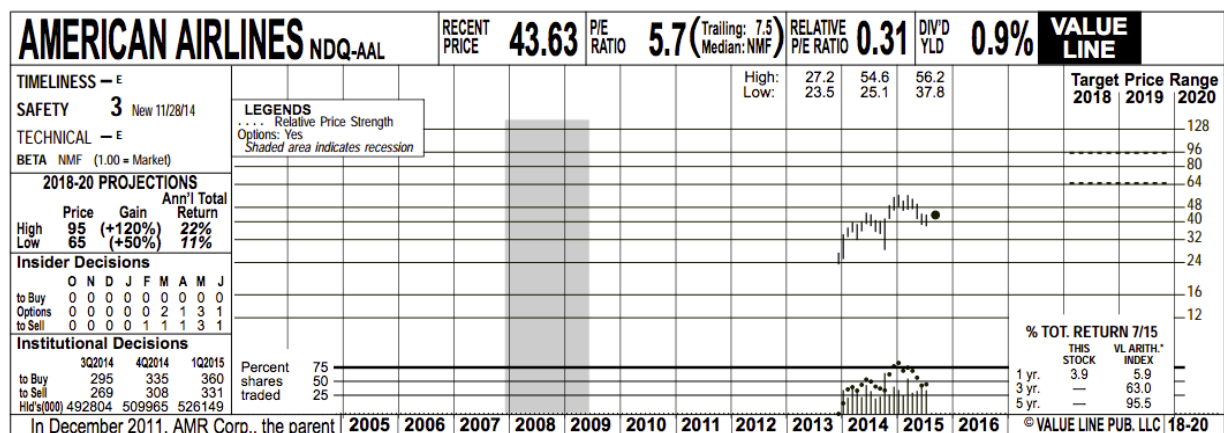


Figure 16. American Airlines Value Line report.

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>

American Airlines is a full-service airline in the United States that is headquartered out of Fort Worth, Texas and operates a diverse fleet and a comprehensive domestic and international route network. The airline was one of the later airlines in the U.S. air transport industry to emerge from bankruptcy, when it also started trading again on Nasdaq on December 9th of 2013 with an initial price of \$26.40 (Trefis Team, 2014). American Airlines' emergence from Chapter 11 bankruptcy allowed administrators to cut costs that would otherwise not be possible through the re-negotiation of contracts with airline employees, office and aircraft lease contracts, and the limiting of pension liabilities (Trefis Team, 2014). With American Airlines' merger with US Airways, the increase in the airline's route network and coverage is attractive to travelers that seek frequent flyer status with an airline in an effort to earn free travel or premium benefits through one of American Airlines' top-tier levels. This increased coverage involves greater interconnectivity between cities along the east coast of the United States with the help of the



former US Airways presence in Philadelphia, Charlotte, and the capital city of Washington D.C. (Trefis Team, 2014).

According to Figure 16, due to the relatively recent emergence from Chapter 11 bankruptcy, there is little historical data on the performance on the stock, in addition to the lack of a timeliness or technical ranking. However, American Airlines earned a safety ranking of 3, which placed the airline in the average risk category along with all of the previously mentioned airlines in this thesis. However, the airline has a relatively low price-to-earnings ratio of only 5.7, meaning that shareholders are only willing to pay \$5.70 for every dollar of earnings (Henigson, 2015b).

### **United Airlines**

United Airlines is a full-service airline headquartered out of Chicago, Illinois with a comprehensive domestic and international route structure and a founding member of the Star Alliance. United Airlines operates a wide variety of Airbus and Boeing aircraft from the smaller Boeing 737 and Airbus A320 to the Boeing 747-400 and Boeing 787 aircraft. As is the strategy for full-service airlines, the wide diversity of the airline's fleet helps United's airline administrators operate flight from short-haul domestic to long-haul international flights. This strategy in conjunction with offering premium classes of service both at the airport and onboard the aircraft demonstrate a product differentiation business-level strategy approach within the executive leadership of United Airlines.

Since the merger between United Airlines and Continental Airlines in 2010 to become United Continental Holdings Inc., the airline has experienced numerous problems, from computer glitches, to frustrated employees and poor customer satisfaction levels (Carey & Nicas,



2015; Mouawad & White, 2015). In comparison to other full-service airlines such as Delta Air Lines or American Airlines, United Airlines has experienced significant delays and has taken longer to integrate the computer systems of its native software and the *Shares* system of the former Continental Airlines. (Carey & Nicas, 2015; Mouawad & White, 2015). This had a negative effect on customer satisfaction, especially with the global grounding of United Airlines' fleet in July of 2015 due to a computer malfunction and a faulty router (Carey & Nicas, 2015). Poor customer satisfaction is reflected in the ACSI score of 60 as depicted in Table 1, which is the lowest-ranked full-service airline, and third from the bottom of the list. According to the U.S. Department of Transportation's (DOT) Bureau of Transportation Statistics (2015a), United Airlines had only 73% of departures and 76% of arrivals on time, which ranked the airline as 13<sup>th</sup> and 12<sup>th</sup>, respectively. With the miscommunication, distrust, and general poor relationship between management and the front-line employees, the customers ended up suffering the brunt of the airline's failures (Mouawad & White, 2015).

With United Airlines as a full-service airline, its airline administrators are at a disadvantage due to its strategy of cutting employee wages, frequent flyer benefits, and squeezing in slimmer seats on board their aircraft, without the operational cost efficiencies of a true low-cost carrier. It is not a sustainable strategy for a long-term investment, which is further reflected in the airline's financial data. According to the annual report for United Airlines, the airline, in 2014 had current assets of \$8.18 billion and current liabilities of \$12.51 billion, which calculates into a current ratio of only 0.65 (United Continental Holdings Inc., 2014).

Considering the current ratio in previous years, using the same current ratio formula of current assets divided by current liabilities, the company's current ratio decreased from 0.78 in 2012, to 0.71 in 2013 before reaching the current ratio of 0.65 for 2014 (United Continental Holdings



<b>UNITED CONT'L</b>						RECENT PRICE		PIE RATIO		RELATIVE PIE RATIO		DIV'D YLD	VALUE LINE				
NYSE-UAL						58.51		5.7		(Trailing: 6.7; Median: NMF)				Nil			
<b>TIMELINESS</b>	1	Raised 6/20/14	High:	3.7	46.5	51.6	41.5	13.3	29.8	27.7	25.8	40.2	67.8	74.5	Target Price Range 2018 2019 2020		
<b>SAFETY</b>	4	Lowered 8/28/15	Low:	0.1	0.0	31.6	2.8	3.1	12.1	15.5	17.3	23.6	36.7	49.8			
<b>TECHNICAL</b>	3	Raised 8/28/15	LEGENDS														
<b>BETA</b>	1.10	(1.00 = Market)	— 4.5 x "Cash Flow" p sh - - - Relative Price Strength Options: Yes Shaded area indicates recession														
<b>2018-20 ProjCTIONS</b>																	
	Price	Gain	Ann'l Total Return														
High	115	(+95%)	18%														
Low	75	(+30%)	6%														
<b>Insider Decisions</b>																	
	O	N	D	J	F	M	A	M	J								
to Buy	0	0	0	0	0	0	0	0	0								
Options	1	0	0	0	0	0	0	0	0								
to Sell	2	1	3	2	1	0	0	0	0								
<b>Institutional Decisions</b>																	
	3Q2014	4Q2014	1Q2015														
to Buy	197	264	259														
to Sell	189	204	238														
Hld's(000)	352980	353721	354432														
				Percent shares traded	75	50	25										
				% TOT. RETURN 7/15													
				THIS STOCK	VL ARITH.' INDEX												
				1 yr.	21.6	5.9											
				3 yr.	198.5	63.0											
				5 yr.	137.5	95.5											
1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
© VALUE LINE PUB. LLC 18-20																	

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>

According to Figure 17, United Continental Holdings, which is the holding company for United Airlines, scored a safety ranking of 4, which was the lowest of all the airlines measured within the scope of this thesis, to include both the low-cost carriers and the full-service airlines (Downing, 2015b). This ranking suggests that United Continental is scored below-average in terms of the safety of investment from a risk perspective, or in other words, United Continental is a riskier-than-average investment for a shareholder. This ranking is corroborated through United Airlines' credit rating through Standard and Poor's, with a grade of BB-, meaning that although



the company is less vulnerable to non-payment, there are major uncertainties or susceptibility to negative financial, business, or economic conditions (Standard and Poor's, 2014, 2015b).

### Alaska Airlines

Alaska Airlines is a full-service airline in the United States that is headquartered in Seattle, Washington, and is operated through its parent company, Alaska Air Group. Alaska Airlines operates a fleet of variants of the Boeing 737 to Hawaii, Alaska, the 48 contiguous states, Canada, Mexico, and Costa Rica. Unlike some other major full-service airlines in the United States, Alaska Airlines does not operate trans-Atlantic flights nor flights to Asia, and is not part of any global airline alliance, but instead focuses on a strong and positive brand image and ensuring that the airline's current routes are profitable (Kalb, 2013). Employees, especially contact personnel for Alaska Airlines have performed to high standards regarding implementing customer satisfaction initiatives, and managers for the airline have also implemented employee satisfaction initiatives through \$116 million in incentive pay for reaching "safety, customer service, operational, and financial goals" (Alaska Air Group Inc., 2014, p. 4). The emphasis on



Figure 18. Alaska Airlines Value Line report.

Source: Value Line Research Center – Investment Survey. <http://www.valueline.com>



employee and customer satisfaction has resulted in being ranked as first in the ACSI rating out of the full-service airlines shown in Table 1 as well as first among J.D. Power's ranking of airline satisfaction for traditional carriers (J.D. Power, 2015b).

According to Figure 18, Alaska Airlines earned a safety ranking of 3, which placed it in with all of the U.S.-based carriers except for United Airlines in terms of the risk of the investment in the airline (Henigson, 2015a). Despite Alaska Airlines' high share price of \$81.51 and relatively high price-to-earnings ratio of \$13.00 compared to other U.S.-based carriers, the airline only earned a timeliness score of 2. Although this placed Alaska Airlines above average among Value Line's 1,700 stocks for short-term six to twelve-month performance, it was apparently ranked lower than all of the other airlines researched in this thesis except for JetBlue Airways. It is interesting to note that despite this ranking, both JetBlue Airways and Alaska Airlines have score highest among the U.S.-based low-cost carriers and full-service airlines, respectively, on customer satisfaction according to ACSI and J.D. Power. To support Alaska Airlines' financial strength, however is a rating of BBB- by the credit rating agency Standard and Poor's (Standard and Poor's, 2015a). This rating is one of the investment-grade ratings, indicating that adverse external circumstances could weaken the company's capacity to make its financial commitments, but has sufficiently displayed enough protection parameters to reduce the amount of negative speculation for the airline (Standard and Poor's, 2014).



### **Findings and Conclusion**

Despite the different business-level strategies implemented by carriers based in the United States, there appears not to be enough reliable evidence on whether a low-cost carrier provides more shareholder value than a full-service airline, or vice versa. One of the long-term strategies implemented by airlines such as JetBlue Airways, Southwest Airlines, and Alaska Airlines have been to build high customer satisfaction, in order to gain repeat customers and positive referrals from customer-to-customer to gain a more sustainable market share. At the same time, while low-cost carrier Southwest Airlines is performing well in terms of customer satisfaction, another low-cost carrier, Spirit Airlines is scored in last place among carriers based in the United States according to the American Customer Satisfaction Index with a score of only 54 as compared to the airline industry average of 71. In addition to this, there is a connection between the customer satisfaction levels and employee satisfaction. Administrators for United Airlines, who have had difficult in negotiating labor contracts with its employee in the aftermath of the airline's Chapter 11 bankruptcy filing has resulted in disengaged employees that has affected the quality of service that they provide, affecting customer satisfaction, and ultimately a segment of competitive advantage. With a new Chief Executive Officer, Oscar Munoz, at the helm of the airline who emphasizes the value of the people in the company, it remains to be seen how United Airlines will perform in the long-term outlook.

Airline administrators must remain vigilant to include other stakeholders that are not shareholders, especially with employees who serve as the representative and front-line staff for the airline. In a service industry such as the air transport industry, it is clear that disengaged and unmotivated employees have a very detrimental effect on customer satisfaction. This is particularly notable in the case of United Airlines, where airline administrators and front-line



employees are still reeling from the effects of the bankruptcy filings from 2002 to 2006 due to the loss of employee pensions. The correlation of employee satisfaction to customer satisfaction is clear through the ranking of United Airlines in the American Customer Satisfaction Index (ACSI) and the J.D. Power North America airline satisfaction study where it ranks last among the full-service airlines. Another example is with Spirit Airlines, where it ranks last among all of the carriers measured by the American Customer Satisfaction Index (ACSI) with a score of 54. Even though there appears to be a misalignment between the customer expectations and actual service quality, its high price-to-earnings ratio of 14.1 and highest share price among the low-cost carriers in August of 2015 represents the disconnect between satisfying the investors and shareholders of Wall Street versus the employees and customers of Main Street. Therefore, the business-level strategy is not an effective indicator of long-term and sustainable shareholder value, but instead involves the participation and satisfaction of employees of the company, who, through their service to the customers, will move the airline forward in long-term and sustainable value.



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**Appendices**



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	B
	NME

NMF

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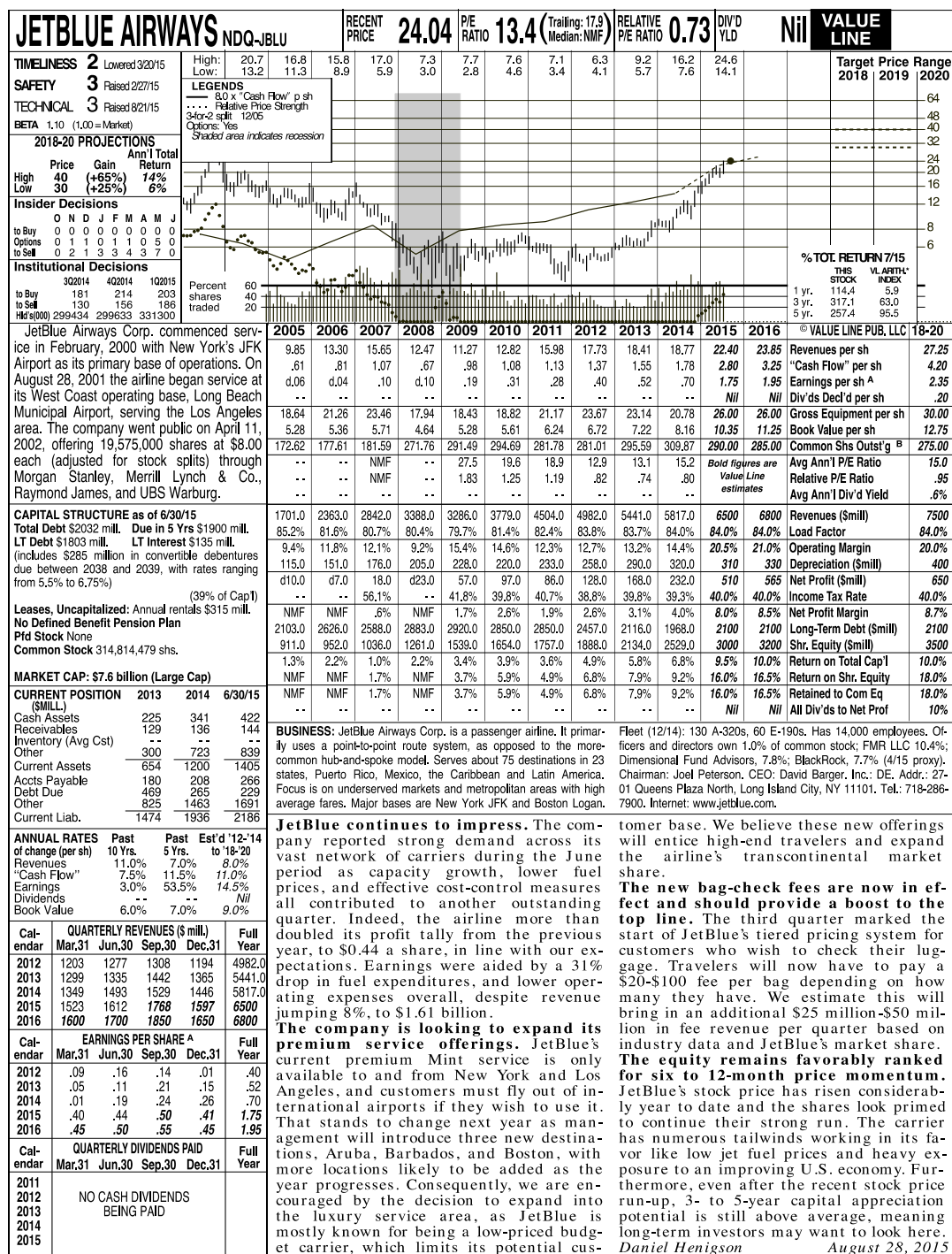


## Appendix C

DELTA AIR LINES NYSE-DAL										RECENT PRICE	47.36	P/E RATIO	9.5 (Trailing: 12.8 Median: NMF)	RELATIVE P/E RATIO	0.52	DIV'D YLD	1.1%	VALUE LINE	Target Price	Range											
TIMELINESS	1	Raised 8/14/15								High: 22.0	19.0	12.6	14.9	13.2	12.3	29.4	20.2	51.1	38.8		2018	2019	2020								
SAFETY	3	Raised 8/29/14								Low: 14.0	4.0	3.5	9.6	6.4	7.8	12.0	57.3	38.8													
TECHNICAL	4	Lowered 8/14/15								LEGENDS ..... 2.0 x "Cash Flow" p/sh ..... Relative Price Strength Options: Yes Shaded area indicates recession																					
BETA	1.20	(1.00 = Market)																													
2018-20 PROJECTIONS																															
Price	Gain	Ann'l Total																													
High	80	(+70%)	15%																												
Low	55	(+15%)	6%																												
Insider Decisions																															
O	N	D	J	F	M	A	M	J																							
to Buy	0	0	0	2	1	0	0	1	0																						
Options	0	0	1	0	0	1	1	1	1																						
to Sell	1	2	2	0	1	1	1	3	2																						
Institutional Decisions																															
3Q2014	4Q2014	1Q2015																													
to Buy	367	421	412																												
to Sell	333	372	408																												
Net Buy	709239	715792	698875																												
Percent shares traded																															
90																															
30																															
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016																															
© VALUE LINE PUB. LLC 18-20																															
--	--	--	--	--	--	85.51	87.01	66.63	32.65	35.80	38.04	41.54	43.07	44.36	48.91	51.25	53.50	Revenues per sh	59.35												
--	--	--	--	--	--	d8.87	6.48	5.50	1.10	.60	3.54	3.21	3.66	5.15	5.54	7.10	8.30	"Cash Flow" per sh	8.05												
--	--	--	--	--	--	d18.28	.02	1.06	d1.08	d1.29	1.71	1.41	1.83	3.14	3.31	4.50	5.75	Earnings per sh	6.75												
--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	Div'ds Decl'd per sh	.90												
--	--	--	--	--	--	126.55	115.27	42.82	31.91	29.79	29.32	30.40	32.15	34.82	37.89	39.00	42.00	Gross Equipment per sh	40.00												
--	--	--	--	--	--	d52.26	d68.88	35.18	1.26	.31	1.07	d1.65	d2.50	13.67	10.68	15.50	22.50	Book Value per sh	28.00												
--	--	--	--	--	--	189.34	197.34	287.48	695.14	783.95	834.72	845.25	851.40	851.44	825.26	795.00	785.00	Common Shs Outstg	750.00												
--	--	--	--	--	--	--	--	17.4	--	--	7.4	6.6	5.5	6.4	11.4	Bold figures are Value Line estimates		Avg Ann'l P/E Ratio	10.0												
--	--	--	--	--	--	--	--	.92	--	--	.47	.41	.35	.36	.60			Relative P/E Ratio	.75												
--	--	--	--	--	--	--	--	--	--	--	--	--	--	--	--			Avg Ann'l Div'd Yield	1.1%												
CAPITAL STRUCTURE as of 6/30/15																															
Total Debt \$9257 mill. Due in 5 Yrs \$7865 mill.																															
LT Debt \$7598 mill. LT Interest \$525 mill. (44% of Cap'l)																															
Leases, Uncapitalized Annual rentals \$6.572 bill.																															
Pension Assets - 12/14 \$9.4 bill. Oblig.\$21.9 bill.																															
Pld Stock None																															
Common Stock 795,398,332 shs.																															
MARKET CAP: \$37.7 billion (Large Cap)																															
CURRENT POSITION 2013 2014 2015 2016																															
CASH ASSETS (\$MILL.)																															
Cash Assets	3925	3305	3787																												
Receivables	1609	2297	1966																												
Inventory	706	534	553																												
Other	3411	6329	5135																												
Current Assets	9651	12465	11441																												
Accts Payable	2300	2622	2803																												
Debt Due	1547	1216	1659																												
Other	10305	13041	12620																												
Current Liab.	14152	16879	17082																												
ANNUAL RATES																															
of change (per sh)	10 Yrs.	Past 5 Yrs.	Past Est'd '12-'14 to '18-'20																												
Sales	--	--	4.5%																												
"Cash Flow"	--	15.0%	11.0%																												
Earnings	--	--	16.0%																												
Dividends	--	--	36.5%																												
Book Value	--	-10.0%	25.0%																												
QUARTERLY REVENUES (\$ mill.)																															
Cal-endar	Mar.31	Jun.30	Sep.30	Dec.31	Full Year																										
2012	8413	9732	9923	8602	36670																										
2013	8500	9707	10490	9076	37773																										
2014	8916	10621	11178	9647	40362																										
2015	9388	10707	11150	9505	40750																										
2016	9680	11050	11475	9795	42000																										
EARNINGS PER SHARE																															
Cal-endar	Mar.31	Jun.30	Sep.30	Dec.31	Full Year																										
2012	d.04	.69	.90	.28	1.83																										
2013	.10	.98	1.41	.65	3.14																										
2014	.33	1.04	1.20	.78	3.35																										
2015	.45	1.27	1.70	1.08	4.50																										
2016	.92	1.60	2.05	1.18	5.75																										
QUARTERLY DIVIDENDS PAID																															
Cal-endar	Mar.31	Jun.30	Sep.30	Dec.31	Full Year																										
2011	--	--	--	--	--																										
2012	--	--	--	--	--																										
2013	--	--	.06	.06	.12																										
2014	.06	.06	.09	.09	.30																										
2015	.09	.09	.135																												
BUSINESS: Delta Air Lines, Inc. is a major international airline with ten airport hubs. Provides service to every major domestic and international market. The revenue mix in 2014 consisted of the following: passenger, 87%; cargo, 2%; other, 11%. 14 revs. Revenues by geographic region: United States, 67%; Atlantic, 17%; Pacific, 10%; Latin America, 6%. Fleet (at 12/31/14): 772 aircraft (587 owned, 185 leased). Acquired Northwest Airlines, 10/08. Has approximately 80,000 employees. The Vanguard Group owns 5.1% of common stock; Officers & Directors, 1.3% (4/15 proxy). Chairman: Daniel A. Carp. Chief Executive Officer: Richard Anderson. Incorporated: DE. Address: P.O. Box 20706, Atlanta, GA 30320-6001. Telephone: 404-715-2600. Internet: www.delta.com.																															
Delta Air Lines posted mixed results in the June quarter. The top line rose slightly year over year, as a number of revenue initiatives and nonpassenger revenue sources helped offset a \$160 million foreign exchange headwind. Volume demand from corporate customers was up 3%, but this was largely offset by fare pressure. A strong U.S. dollar and lower fuel surcharges remain challenges for the international business. Meanwhile, softer yields in three domestic markets caused U.S. revenues to fall short of expectations. We suspect the "oil patch" was one of these problem areas, a trend that should continue in the current quarter. Overall, passenger revenue per average seat mile (PRASM) dropped 4.6%, with 2.5 points attributable to currency and lower surcharges, with the rest coming from lower domestic yields. Nonetheless, an 18% decline in fuel prices led earnings per share 22% higher year over year, even with a \$600 million hedge loss. Notably, the fuel hedge headwind experienced for the past six months is now in the past, and DAL expects to pay fuel prices that are in line with the industry.																															
The company expects record earnings in the current quarter. Currency volatility and weak domestic yields ought to persist in the September interim. Thus, total revenue should decline slightly with PRASM down 4.5%-6.5% on three points of additional capacity. Still, roughly \$1 billion in lower fuel prices should more than offset this, leading to share-net growth of over 30% and 400 basis points of operating margin improvement. Nonfuel cost per average seat mile should be flat in September quarter, as cost-reduction initiatives continue to keep this metric below capacity growth.																															
The company continues to be generous with cash return. Delta spent \$1 billion for dividends and share repurchases during the June quarter. It also lowered its debt position by \$250 million. We expect DAL to continue with its policy of returning 50% of free cash flow to investors. These shares are top-ranked for Timeliness. Lower oil prices continue to benefit the bottom line. Nonetheless, if fuel prices do reverse course, we think the stock price will suffer moderately.																															
Kevin Downing August 28, 2015																															
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(A) Diluted eps. Excludes nonrecurring gains (losses): '07, \$3.02, '08, (\$18.00), '09, (21c); '10, (\$1.00); '11, (.40c); '12, (.64c). Next earnings report due late Oct.																															
(B) Incl. intangibles. In '14: \$14.40 bill. '17: \$0.05/sh.																															
(C) In millions.																															
(D) Acquired Northwest Airlines, 10/29/08.																															
(E) Initiated quarterly dividend 5/8/13. Historically paid in mid-Feb., early May, early August, and early November.																															
Company's Financial Strength B+																															
Stock's Price Stability 25																															
Price Growth Persistence 60																															
Earnings Predictability 20																															
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## Appendix D



(A) Diluted earnings. Excludes nonrecurring gains / (losses): '03, 7c; '05, (7c); '06, 4c; '08, (24c); '09, 1c. Earnings may not sum due to changes in diluted share count. Next earnings report due late October.

(B) In millions, adjusted for stock splits.

Company's Financial Strength B+  
 Stock's Price Stability 30  
 Price Growth Persistence 35  
 Earnings Predictability 45

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## Appendix E

SOUTHWEST AIRLINES										NYSE-LUV	RECENT PRICE	40.19	P/E RATIO	11.7	(Trailing: 17.3 Median: 22.0)	RELATIVE P/E RATIO	0.64	DIV'D YLD	0.7%	VALUE LINE	Target Price	2018	2019	2020					
TIMELINESS 1		Raised 5/29/15		High: 17.1		17.0		18.2		17.0		16.8		11.8		14.3		13.6		10.6		19.0		43.2		47.2			
SAFETY 3		New 7/27/00		Low: 12.9		13.0		14.6		12.1		7.1		4.9		10.4		7.1		7.8		10.4		18.8		31.4			
TECHNICAL 4		Lowered 8/14/15		LEGENDS		11.0 x "Cash Flow" p sh		Relative Price Strength		Options: Yes		Shaded area indicates recession																	
BETA 1.10		(1.00 = Market)																											
2018-20 PROJECTIONS																													
Price		Gain		Ann'l Total		Return																							
High		75		(+85%)		18%																							
Low		50		(+25%)		6%																							
Insider Decisions																													
O		N		D		J		F		M		A		M		J													
To Buy		0		0		0		0		0		0		0		0													
Options		0		2		0		0		0		0		0		0													
To Sell		0		4		0		1		0		0		0		0													
Institutional Decisions																													
3Q2014		4Q2014		1Q2015																									
To Buy		254		357		327																							
To Sell		299		297		364																							
HR(100)		535657		522504		521804																							
Percent shares traded																													
30		30		30		30		30		30		30		30		30		30		30		30		30		30		30	
1 yr. 28.9 5.9																													
3 yr. 302.5 63.0																													
5 yr. 206.3 95.5																													
% TOT. RETURN 7/15																													
THIS STOCK 11.7																													
V. AVERAGE INDEX																													
1 yr. 28.9 5.9																													
3 yr. 302.5 63.0																													
5 yr. 206.3 95.5																													
© VALUE LINE PUB. LIC. 18-20																													
1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016																													
6.32 7.47 7.24 7.11 7.52 8.32 9.52 11.60 13.42 14.90 13.93 16.19 20.27 23.40 25.21 27.52 30.00 32.95 Revenues per sh 36.30																													
.97 1.20 .95 .71 .86 .95 1.18 1.41 1.40 1.21 1.02 1.58 1.35 1.73 2.31 3.07 4.95 5.25 "Cash Flow" per sh 5.90																													
.59 .79 .51 .24 .36 .38 .57 .72 .61 .40 .19 .73 .43 .56 1.05 1.64 3.40 3.60 Earnings per sh A 4.00																													
.01 .02 .02 .02 .02 .02 .02 .02 .02 .02 .02 .02 .02 .02 .13 .22 .30 .40 Div's Decl'd per sh B .50																													
9.14 10.54 11.61 12.17 13.36 15.19 16.22 17.69 20.63 21.45 21.39 21.87 23.84 26.70 29.66 33.30 33.00 33.00 Gross Equipment per sh 35.00																													
3.79 4.56 5.24 5.69 6.40 7.04 8.38 8.23 9.45 6.69 7.36 8.34 8.90 9.57 10.45 10.02 13.85 16.00 Book Value per sh 20.85																													
749.14 756.24 766.77 776.66 789.39 784.98 796.44 783.31 734.80 739.99 742.79 747.43 772.56 730.32 702.00 675.99 650.00 625.00 Common Shs Outst'g C 600.00																													
21.1 19.0 35.8 67.4 44.8 39.2 25.9 22.9 24.2 31.6 41.8 17.0 24.2 16.0 13.5 17.6 Bold figures are Value Line estimates Avg Ann'l P/E Ratio 16.0																													
1.20 1.24 1.83 3.68 2.55 2.07 1.38 1.24 1.28 1.90 2.78 1.08 1.52 1.02 .76 .92 Relative P/E Ratio 1.00																													
.1% .1% .1% .1% .1% .1% .1% .1% .1% .2% .2% .2% .2% .4% .9% .8% Avg Ann'l Div'd Yield .8%																													
CAPITAL STRUCTURE as of 6/30/15																													
Total Debt \$2687 mill. Due in 5 Yrs \$2000 mill. Revenues (\$mill) 22500																													
LT Debt \$2411 mill. LT Interest \$120 mill. Load Factor 81.0%																													
(25% of Cap'l) Operating Margin 21.0%																													
Depreciation (\$mill) 1000																													
Net Profit (\$mill) 2400																													
Income Tax Rate 38.0%																													
Net Profit Margin 10.7%																													
Long-Term Debt (\$mill) 2000																													
Shr. Equity (\$mill) 12000																													
Return on Total Cap'l 17.0%																													
Return on Shr. Equity 20.0%																													
Retained to Com Eq 18.0%																													
All Div'ds to Net Prof 13%																													
Leases, Uncapitalized Annual rentals \$715 mill.																													
No Defined Benefit Pension Plan																													
Pfd Stock None																													
Common Stock 659,355,000 shs.																													
MARKET CAP: \$26.5 billion (Large Cap)																													
CURRENT POSITION																													
2013 2014 6/30/15																													
(MILL.)																													
Cash Assets 3152 2988 3132																													
Receivables 419 365 462																													
Inventory (Avg Cst) 467 342 326																													
Other 418 709 676																													
Current Assets 4456 4404 4596																													
Accts Payable 1247 1203 1134																													
Debt Due 629 258 276																													
Other 3800 4462 5466																													
Current Liab. 5676 5923 6876																													
ANNUAL RATES																													
10 Yrs. 5 Yrs. Est'd '12-'14																													
of change (per sh)																													
Revenues 12.5% 12.5% 6.0%																													
"Cash Flow" 11.0% 14.5% 10.0%																													
Earnings 12.5% 22.0% 17.0%																													
Dividends 22.0% 46.5% 31.0%																													
Book Value 4.5% 5.0% 8.5%																													
QUARTERLY REVENUES (\$ mill)																													
Full Year																													
Cal-end. Mar.31 Jun.30 Sep.30 Dec.31																													
2012 3990 4616 4309 4173 17088																													
2013 4084 4643 4544 4428 17699																													
2014 4166 5011 4800 4628 18605																													
2015 4414 5111 5100 4875 19500																													
2016 4500 5700 5500 4940 20600																													
EARNINGS PER SHARE A																													
Full Year																													
Cal-end. Mar.31 Jun.30 Sep.30 Dec.31																													
2012 .13 .30 .02 .11 .56																													
2013 .08 .31 .37 .29 1.05																													
2014 .22 .67 .48 .27 1.64																													
2015 .66 1.03 .95 .76 3.40																													
2016 .70 1.05 1.15 1.70 3.60																													
QUARTERLY DIVIDENDS PAID B																													
Full Year																													
Cal-end. Mar.31 Jun.30 Sep.30 Dec.31																													
2011 .005 .005 .005 .005 .02																													
2012 .005 .005 .01 .01 .03																													
2013 .010 .010 .040 .040 .10																													
2014 .040 .040 .060 .060 .20																													
2015 .060 .075 .075 .075 .20																													
(A) Diluted earnings. Includes profits and losses from sale of operating equipment. Excludes nonrecurring gains/losses: '01, '12c; '05, '7c; '06, '11c; '07, '23c; '08, '16c; '09, '12c; '10, '12c; '11, '20c. Quarterly totals may not sum to year-end figures due to changes in outstanding shares. Next earnings report due late October.																													
(B) Dividends historically paid in early January and late March, June, and September.																													
(C) In millions.																													
BUSINESS: Southwest Airlines is one of the largest carriers in the United States by revenues and the largest by passengers flown. Specializes in low fares & short-hauls. Uses point-to-point, versus common hub-and-spoke model. Acquired AirTran, 5/11. At 12/31/14, served 96 cities; operated fleet of 678 aircraft (178 leased); On order: 321 additional aircraft, w/ option for 242 more.																													
Has approximately 47,000 employees. Ownership: PRIMECAP Management, 11.6%; Vanguard Group, 5.6%; FMS LLC, 5.3%; officers and directors, less than 1% (4/15 proxy). Chairman/CEO/President: Gary Kelly, Incorporated. TX. Address: P.O. Box 36611, 2702 Love Field Drive, Dallas, TX 75235. Tel: 214-904-4000. Internet: www.southwest.com.																													
Cheaper fuel helped Southwest Airlines to another outstanding quarter. The Dallas-based company reported \$691 million in earnings during the June period, or \$1.03 per share, its second-straight record quarterly profit and the highest in its 48-year history. Lower jet fuel prices, at about \$2 a gallon—down 33% from last season—provided a \$500 million savings boon that drove expenses down substantially and brought operating margins to a record high. Also, management believes that fuel prices will continue to remain near current levels for at the least the next several quarters. Should that be the case, our estimates—which incorporate higher average oil prices next year—may be too conservative, and considerable upside to earnings could be a possibility. Demand is growing nicely. Southwest's planes flew at a record 85% full in the second period despite a 7% boost in available seats. To accommodate the increased airline traffic, management added new flight routes and airport runway slots, and ordered several new aircraft for its burgeoning fleet. Further, the company reduced its ticket fares in an effort to compete with																													
some of the other low-cost carriers, and that probably helped stimulate demand during the quarter, as well. A labor dispute could be brewing. The union for Southwest's flight attendants recently turned down a six-year labor agreement. The negotiations have been ongoing for more than a year, and there have been several actions taken by both sides in order to secure the right contract for their respective parties. For now, we view this dispute as merely a distraction. However, in the future, the two sides will have to come to an agreement that meets the needs of both the staff and company. Stock repurchases should continue at a robust pace. The company returned \$430 million in capital to investors during the most recent quarter (\$380 million in share repurchases and \$50 million in dividends.) A new buyback program worth \$1.5 billion was initiated back in May. Also, the board of directors raised the quarterly payout 25%, to \$0.075 a share. These shares remain a top pick for momentum investors. Long-term appreciation potential is noteworthy, as well. Daniel Henigson August 28, 2015																													
Stock's Financial Strength A																													
Company's Price Stability 55																													
Price Growth Persistence 40																													
Earnings Predictability 45																													
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To subscribe call 1-800-VALUENE																													



SPIRIT AIRLINES				RECENT PRICE	61.33	P/RATIO	14.1	(Trailing: 16.8 Median: NMF)	RELATIVE P/E RATIO	0.77	DIV YLD	Nil	VALUE LINE
NDQ-SAVE													
TIMELINESS 1				Raised 6/5/15				High: 17.5				Target	
SAFETY 3				New 12/21/11				Low: 10.2				2018	
TECHNICAL 4				Lowered 8/29/15				24.8				2019	
BETA 1.20				(1.00 = Market)				13.9				Range	
2018-20 PROJECTIONS								47.6				2020	
								85.4					
								34.3					
								83.4					
								57.3					



UNITED CONT'L NYSE-UAL				RECENT PRICE	58.51	P/RATIO	5.7 (Trailing: 6.7 Median:NMF)	RELATIVE P/E RATIO	0.31	DIV YLD	Nil	VALUE LINE	Target Price	Range 2018 2019 2020												
<b>TIMELINESS</b> 1 Raised 6/20/14	High: 3.7	2.4	46.5	51.6	41.5	13.3	29.1	27.7	25.8	40.2	67.8	74.5														
<b>SAFETY</b> 4 Lowered 8/29/15	Low: 0.1	0.3	0.0	31.6	2.8	3.1	12.8	15.5	17.3	23.6	36.7	49.8														
<b>TECHNICAL</b> 3 Raised 8/29/15	<b>LEGENDS</b> ▲ S = Cash Flow* p sh --- Relative Price Strength Options: Yes Shaded area indicates recession																									
<b>BETA</b> 1.10 (1.00 = Market)																										
<b>2018-20 PROJECTIONS</b>	Price	Gain	Ann'l Total																							
High	115	(+95%)	18%																							
Low	75	(+30%)	6%																							
<b>Insider Decisions</b>	O	N	D	J	F	M	A	M	J																	
To Buy	0	0	0	0	0	0	0	0	0																	
To Sell	1	0	0	0	0	0	0	0	0																	
<b>Institutional Decisions</b>	O	N	D	J	F	M	A	M	J																	
To Buy	197	264	259																							
To Sell	189	204	238																							
Net Buy/Sell	352980	353721	354432																							
<b>1999-2016</b>	302014	402014	102015	Percent shares traded	75	50	25																			
1 yr.	21.6	5.9	15.5																							
3 yr.	198.5	63.0	95.5																							
5 yr.	137.5	95.5	15.5																							
<b>© VALUE LINE PUBL.</b>	<b>18-20</b>																									
355.03	368.34	293.50	173.44	124.29	141.03	149.53	172.25	171.89	144.20	97.46	103.72	112.15	111.74	105.66	<b>100.00</b>	<b>103.95</b>	Revenues per sh	<b>124.65</b>								
29.88	25.11	41.04	61.45	65.59	62.83	2.57	7.74	10.63	63.88	61.35	96.65	8.67	6.35	7.65	9.73	<b>15.25</b>	<b>15.85</b>	"Cash Flow" per sh	<b>18.50</b>							
5.87	2.38	43.23	43.56	41.50	49.87	44.88	41.16	2.32	41.63	47.49	4.30	3.49	1.59	2.84	5.06	<b>10.80</b>	<b>11.50</b>	Earnings per sh	<b>11.90</b>							
--	94	36	--	--	--	--	--	--	--	--	--	--	--	--	--	<b>Nil</b>	<b>Nil</b>	Div's Decl'd per sh	<b>Nil</b>							
408.00	429.51	400.04	269.05	186.13	174.50	172.71	107.29	107.67	86.65	72.76	61.78	63.43	69.21	62.03	67.08	<b>70.00</b>	<b>72.00</b>	Gross Equipment per sh	<b>75.00</b>							
108.00	98.78	55.16	63.15	653.58	668.08	d219.93	19.13	20.68	617.60	d16.77	5.27	5.46	1.45	8.90	7.04	<b>16.50</b>	<b>30.00</b>	Book Value per sh	<b>46.00</b>							
50.78	52.54																									



## Appendix H

# COMPARISON OF SHAREHOLDER VALUE: FULL-SERVICE AIRLINES VS. LOW-COST CARRIERS

THESIS DEFENSE | PRESENTED BY:

WILLIAM KEE

LEE HONORS COLLEGE & COLLEGE OF AVIATION

DECEMBER 10, 2015

## Agenda

- Thesis Overview
- Creating Shareholder Value
- Focus on the U.S. Air Transport Industry
- Key Airline Industry Performance Indicators
- Analysis of Low-Cost Carriers [Overview]
- Analysis of Full-Service Airlines [Overview]
- Shareholder Value Comparison
- Findings
- Q & A



## Thesis Overview

---

This thesis will explore the business-level strategies, cost leadership and product differentiation, implemented in the air transport industry as a low-cost carrier (LCC) or a full-service airline (FSA).

The emphasis of this thesis will **investigate the value proposition** generated between the LCC versus the FSA strategy, specifically **for the customer (passenger) and the shareholder** while isolating data from the external mitigating factors such as from the political, economic, social, technological, and environmental environments.

The question explored:

***Do LCCs provide equal shareholder value to the FSAs?***

## The Shareholder (or Stockholder)

---

*An individual or a group of individuals that has legal ownership in a corporation through shares or equity, often seen as the external management (Huse, 2007).*





## Shareholder Value

---

*“...a measurement of the change in value of the firm’s investment over a period of time...as determined by the financial markets”*

*(Johnson, 2001, p. 141).*



Source: Johnson, R. E. (2001, October). Shareholder value – A business experience. Butterworth-Heinemann.

## Creating Shareholder Value

---

- In order to enhance shareholder value, the company must create **market value** through a competitive advantage
- Value is returned to the shareholder through the use of dividends or increase in share price
- The 1990s were a period in which ‘shareholder supremacy’ was the dominant corporate governance model (Huse, 2007).
- The focus on such short-term value creating was rarely sustainable which evolved into opportunism and ‘heartless’ ownership
- Longer-term value creation takes into account the other internal or external stakeholders in a corporation (i.e.: customers and employees)

Source: (Huse, 2007; Johnson, 2001; Mauboussin, 2011).



## The U.S. Air Transport Industry

---

- The U.S. air transport industry is an intensely competitive industry but also benefits from anti-cabotage laws ([49 U.S. Code § 41703](#))
- Foreign carriers are **prohibited** from operating between two points within the United States *except* under certain **emergency circumstances** after efforts to **meet that emergency with U.S. carriers are exhausted**
  - Less competition
  - Market share of domestic routes limited to U.S. carriers
  - More revenue potential for airlines

## The U.S. Air Transport Industry

---

- Incidents affecting or involving airlines or major airports often become mainstream media headlines (increased public scrutiny)
- Often affected by external environment (price per barrel of oil, political issues, terrorism)
- The modern-day customer is greatly empowered with the Internet and social media
- An airline's reputation can be greatly affected by online and word-of-mouth reviews



## The U.S. Air Transport Industry: Low-Cost Carriers (LCCs)

---

- Some of the low-cost carriers in the United States include Southwest Airlines, JetBlue Airways, and Spirit Airlines
- Zealous focus on the cost model as they implement a cost leadership strategy to achieve a competitive advantage
- Targets price-sensitive travelers
- LCC administrators focus on lowering costs, passing cost savings to the customer, alongside benefit parity or benefit reduction (Holloway, 2008)



## The U.S. Air Transport Industry: Low-Cost Carriers (LCCs)

---

- Route options often characterized as a point-to-point network
- There is *usually* only one class of service
- Extra amenities are often charged as ancillary fees, especially for ultra-low cost carrier Spirit Airlines
- Often a single family type of aircraft for cost efficiencies
- Lack of flexibility for long-haul trans-oceanic flights





## The U.S. Air Transport Industry: Full-Service Airlines (FSAs)

- Some of the full-service airlines in the United States include Delta, American, United, and Alaska Airlines
- Zealous focus on the revenue model as they implement a product differentiation strategy to achieve a competitive advantage
- Generally, FSA administrators focus on innovative product design, brand image, and loyal customer base (Holloway, 2008)
- Many full-service airlines are members of a global airline alliance to facilitate greater network coverage and more connections



## The U.S. Air Transport Industry: Full-Service Airlines (FSAs)

- FSAs utilize hub-and-spoke networks and often have airport lounges for its premium-class and frequent flyer passengers at major airports
- Many full-service airlines adopt a diverse fleet and wide range of destinations
- Array of top-tier frequent flyer benefits

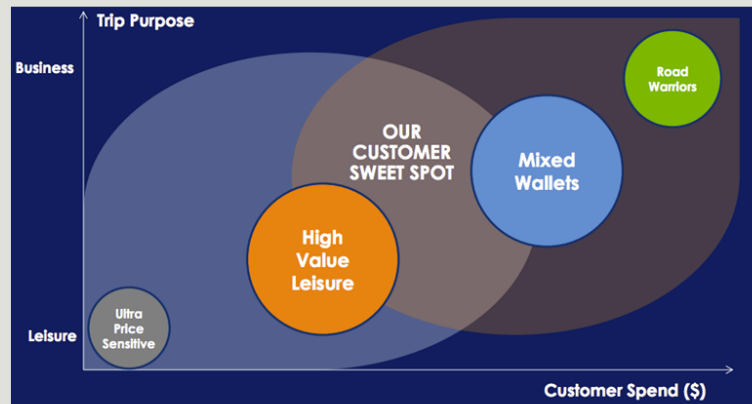




## The U.S. Air Transport Industry: Special Case Study: JetBlue

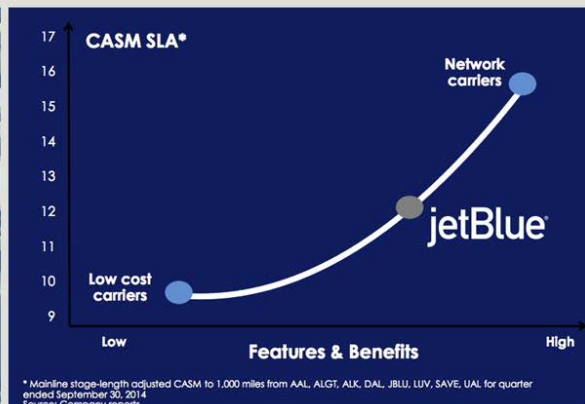
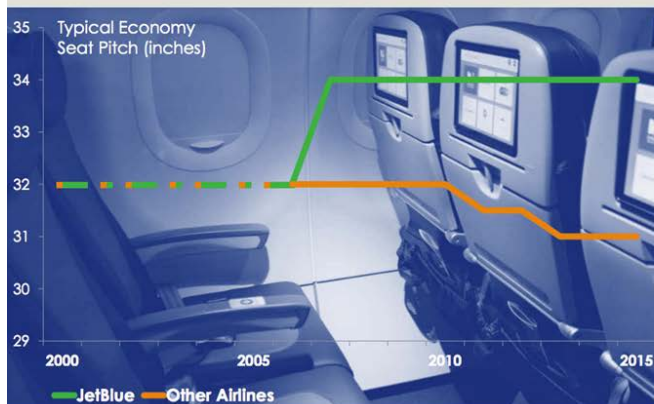
jetBlue  
AIRWAYS

- JetBlue Airways operates a hybrid of the product differentiation and cost leadership business-level strategies
- Airline administrators are attempting to bridge the gap between low-cost carrier and full-service airline



## The U.S. Air Transport Industry: Special Case Study: JetBlue

jetBlue  
AIRWAYS





## The U.S. Air Transport Industry: Special Case Study: JetBlue

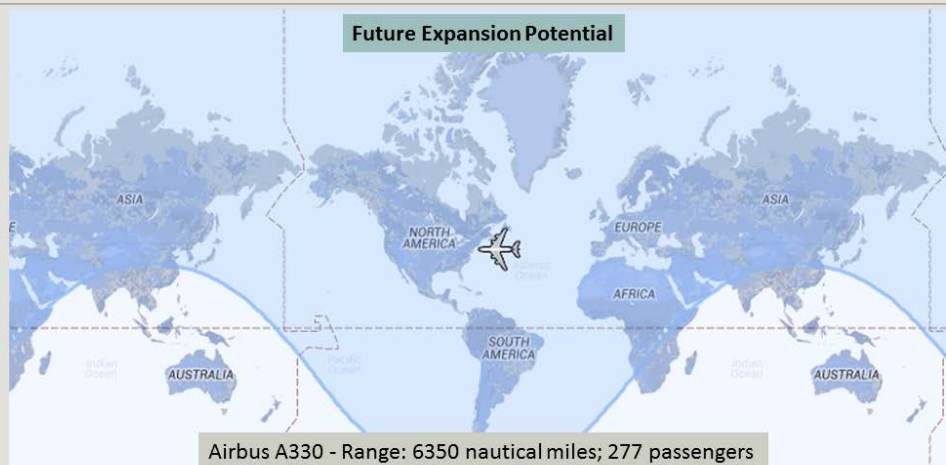
jetBlue  
AIRWAYS



Source: <http://www.airbus.com>

## The U.S. Air Transport Industry: Special Case Study: JetBlue

jetBlue  
AIRWAYS



Source: <http://www.airbus.com>



## Case Study: United Airlines

### Employee Satisfaction vs. Customer Satisfaction



- Historical contention in labor management relationships (filed bankruptcy December 2002; emerged February 2006)
- Former CEO Jeffrey Smisek's departure from United Airlines
- Damage control by new United Airlines CEO, Oscar Munoz
- Former management was an example of how poor employee satisfaction negatively affected customer satisfaction
- New CEO emphasizes importance of the 'human approach' in a service industry, something that was not a top priority during Mr. Smisek's leadership

## American Customer Satisfaction Index: U.S. Airline Industry Benchmarks



American Customer  
Satisfaction Index™

	Base line	05	06	07	08	09	10	11	12	13	14	15	Previous Year % Change	First Year % Change
<b>JetBlue</b>	NM	NM	NM	NM	NM	NM	NM	NM	81	83	79	81	2.5	0.0
<b>Southwest</b>	78	74	74	76	79	81	79	81	77	81	78	78	0.0	0.0
<b>Alaska</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	75	N/A	N/A
<b>Airlines</b>	72	66	65	63	62	64	66	65	67	69	69	71	2.9	-1.4
<b>Delta</b>	77	65	64	59	60	64	62	56	65	68	71	71	0.0	-7.8
<b>American</b>	70	64	62	60	62	60	63	63	64	65	66	66	0.0	-5.7
<b>Allegiant</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	65	N/A	N/A
<b>United</b>	71	61	63	56	56	56	60	61	62	62	60	60	0.0	-15.5
<b>Frontier</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	58	N/A	N/A
<b>Spirit</b>	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	54	N/A	N/A

Source: Benchmarks by industry: Airlines by the American Customer Satisfaction Index (ACSI), Ann Arbor, MI: Author. <http://www.acsi.org>

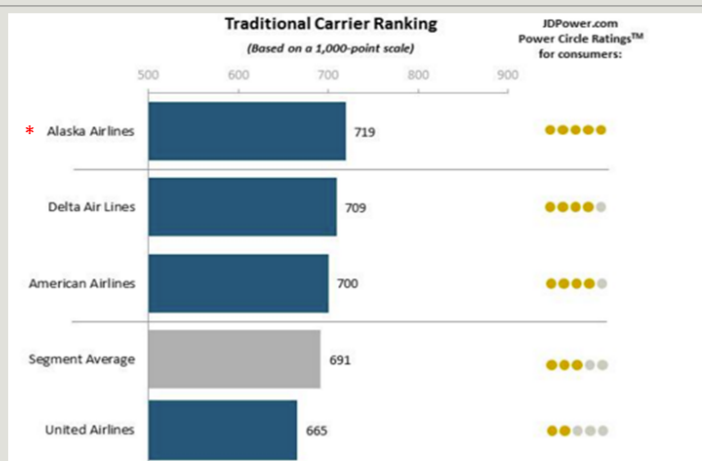


## J.D. Power 2015 North America Airline Satisfaction Study (LCCs)



Source: J.D. Power 2015 North America Airline Satisfaction Study

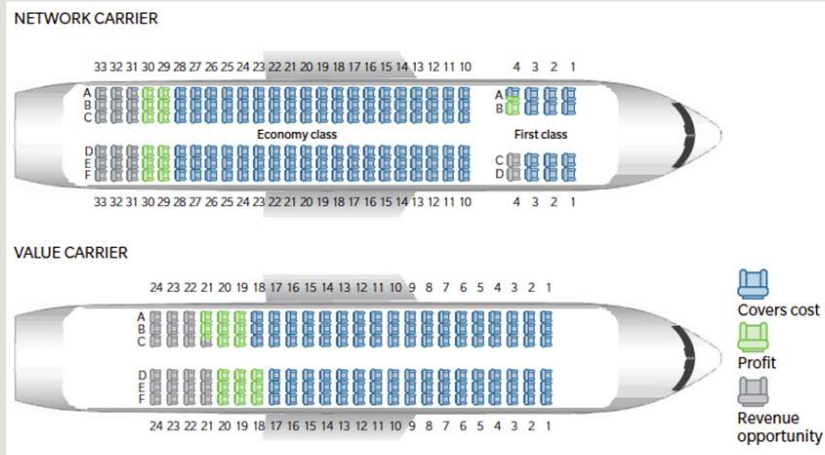
## J.D. Power 2015 North America Airline Satisfaction Study (FSAs)



Source: J.D. Power 2015 North America Airline Satisfaction Study



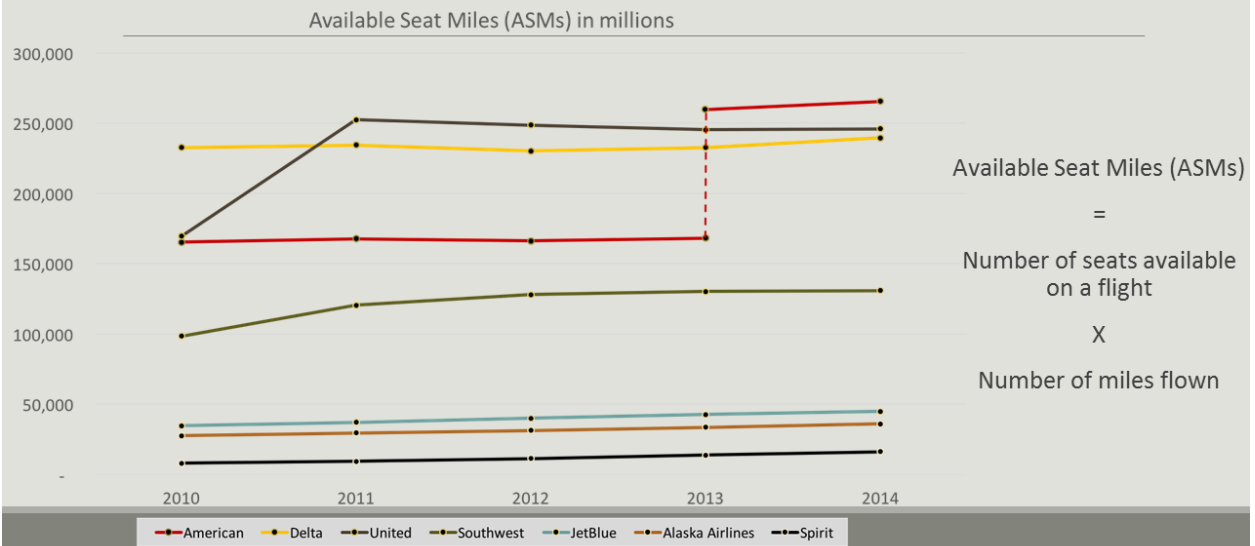
## Airline Industry Performance Indicators: Break Even Load Factor (BELF)



- Number of seats that must be sold for an airline to break even
- Any additional seats that are sold are a source of income for a particular flight segment

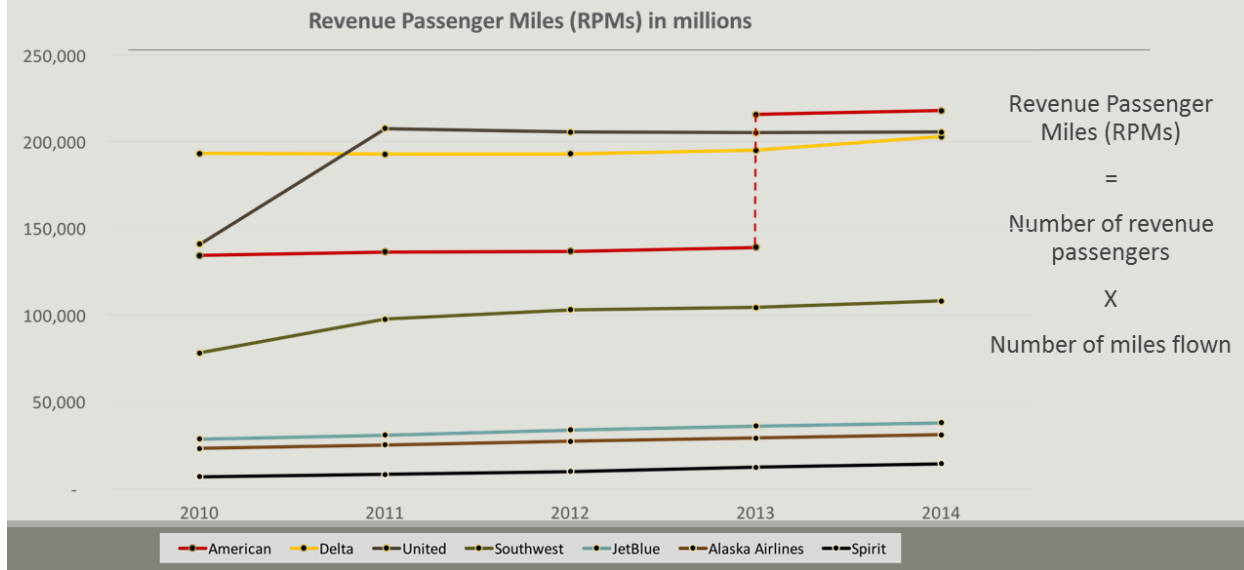
Source: Airline economic analysis by Hazel, Stalnaker, Taylor, & Usman, New York, NY: Oliver Wyman.

## Airline Industry Performance Indicators

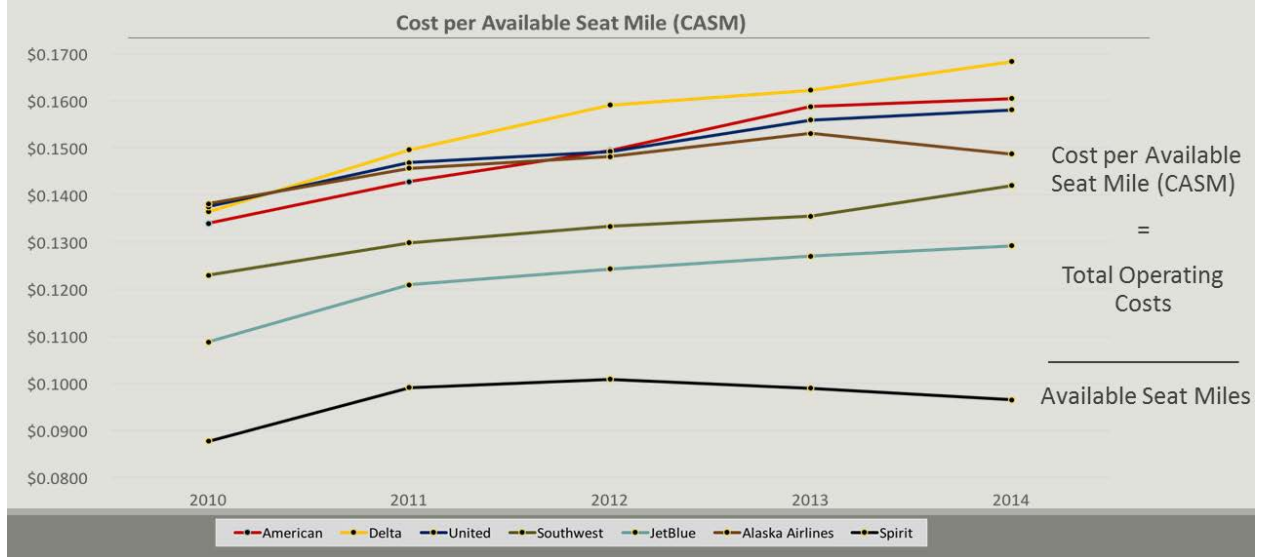




## Airline Industry Performance Indicators



## Airline Industry Performance Indicators





## Price-to-Earnings Ratio Compared with Customer Satisfaction Scores

	Airline	P/E Ratio	Relative P/E Ratio	ACSI Score	J.D. Power
<b>Low-Cost Carriers</b> (JD Power Segment Average: 766)	Spirit Airlines	14.1	0.77	54	NR
	JetBlue Airways**	13.4	0.73	81	801*
	Southwest Airlines	11.7	0.64	78	781
	Airline	P/E Ratio	Relative P/E Ratio	ACSI Score	J.D. Power
<b>Full-Service Airlines</b> (JD Power Segment Average: 691)	Alaska Airlines	13.0	0.71	75	719
	Delta Air Lines	9.5	0.52	71 (industry avg.)	709
	American Airlines	5.7	0.31	66	700
	United Airlines	5.7	0.31	60	665

P/E Statistics Source: Value Line Research Center – Investment Survey (August 2015 data)

## Price-to-Earnings Ratio Compared with Share Price and Current Ratio

	Airline	P/E Ratio	Relative P/E Ratio	Share Price (08/28/2015)	Current Ratio (2014)
<b>Low-Cost Carriers</b>	Spirit Airlines	14.1	0.77	\$61.33	2.00
	JetBlue Airways	13.4	0.73	\$24.04	0.62
	Southwest Airlines	11.7	0.64	\$40.19	0.74
	Airline	P/E Ratio	Relative P/E Ratio	Share Price (08/28/2015)	Current Ratio (2014)
<b>Full-Service Airlines</b>	Alaska Airlines	13.0	0.71	\$81.51	1.05
	Delta Air Lines	9.5	0.52	\$47.36	0.74
	American Airlines	5.7	0.31	\$43.63	0.90
	United Airlines	5.7	0.31	\$58.51	0.65

P/E Statistics/Share Price -- Source: Value Line Research Center – Investment Survey (August 2015 data) | Current Ratio source: Airline SEC 10-K Filings



## Findings

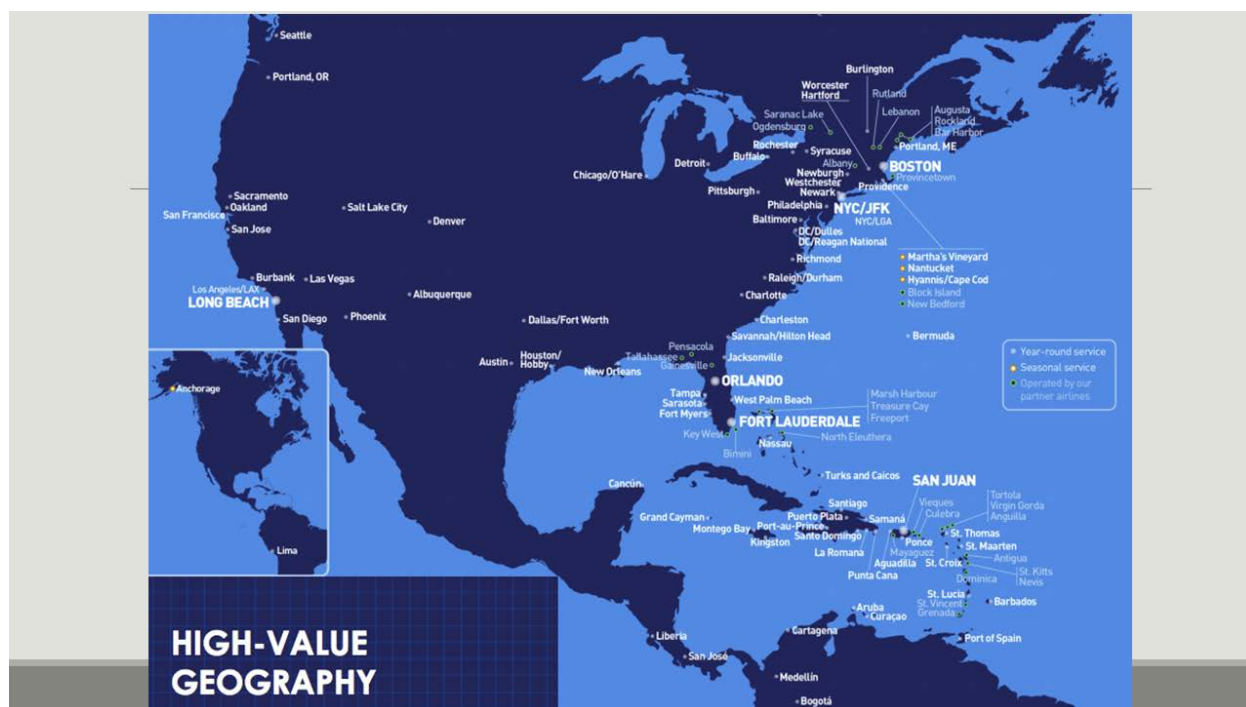
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- There is insufficient evidence that low-cost carriers provide more shareholder value than full-service airlines
- A disconnect between Wall Street and “*Main St.*” [employees] (competing interests)
- Long-term sustainability must involve higher employee satisfaction
- Therefore, the business-level strategy is **not** an effective indicator of shareholder value

QUESTIONS?

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## Airline Industry Performance Indicators

### Available Seat Miles (ASMs)

	Available Seat Miles (millions)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	165,420	167,828	166,223	168,340	
AA/US Airways (post-merger)				259,914	265,657
Delta Air Lines	232,684	234,656	230,415	232,740	239,676
UAL/Continental	169,565	252,528	248,860	245,354	246,021
Southwest	98,437	120,579	128,137	130,344	131,004
JetBlue	34,744	37,232	40,075	42,824	44,994
Alaska Airlines	27,736	29,627	31,428	33,672	36,078
Spirit Airlines	8,120	9,353	11,344	13,861	16,340



## Airline Industry Performance Indicators

### Revenue Passenger Miles (RPMs)

	Revenue Passenger Miles (millions)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	134,298	136,386	136,620	138,878	
AA/US Airways (post-merger)				215,541	217,870
Delta Air Lines	193,169	192,767	192,974	194,988	202,925
UAL/Continental	140,857	207,531	205,485	205,167	205,559
Southwest	78,047	97,583	102,875	104,348	108,035
JetBlue	28,279	30,698	33,563	35,836	37,813
Alaska Airlines	22,841	25,032	27,007	28,833	30,718
Spirit Airlines	6,664	8,007	9,664	12,001	14,159

## Airline Industry Performance Indicators

### Cost per Available Seat Mile (CASM)

	CASM (Cost per available seat mile)				
	2010	2011	2012	2013	2014
American Airlines (pre-merger)	\$0.1340	\$0.1429	\$0.1495		
AA/US Airways (post-merger)				\$0.1589	\$0.1605
Delta Air Lines	\$0.1365	\$0.1496	\$0.1591	\$0.1623	\$0.1684
UAL/Continental	\$0.1376	\$0.1470	\$0.1493	\$0.1560	\$0.1581
Southwest	\$0.1230	\$0.1299	\$0.1334	\$0.1356	\$0.1420
JetBlue	\$0.1088	\$0.1210	\$0.1243	\$0.1271	\$0.1293
Alaska Airlines	\$0.1382	\$0.1457	\$0.1482	\$0.1531	\$0.1488
Spirit Airlines	\$0.0877	\$0.0991	\$0.1009	\$0.0990	\$0.0965



## Airline Analysis



- Southwest Airlines; CEO Gary Kelly
  - Pioneered low-cost model
- Low-Cost Carrier based out of Dallas, Texas
- Low-Cost carrier with upper management advocating a more human approach, which has a positive effect on customer satisfaction
  - Free checked bags
- 2<sup>nd</sup> Place in J.D. Power North American Customer Satisfaction Ranking for LCCs
- Good labor management relations

## Airline Analysis



- Spirit Airlines is an ultra low-cost carrier
- Extras are charged as ancillary fees (printing boarding pass, credit card processing fees, tight carry-on bag restrictions, etc.)
- Very low cost model
- Very high current ratio, which reduces the risk of default for the airline
- Disconnect between customer expectations for the airline and the actual service being provided
- Spirit Airlines has a competitive advantage through its low "bare" fares



## Airline Analysis



- Alaska Airlines is a full-service airline based out of Seattle, Washington
- Much more limited route network than the other full-service airlines based in the United States
- Awarded 1<sup>st</sup> Place in J.D. Power North American Airline Satisfaction Rankings (FSAs) for 8 consecutive years
- Excellent brand image
- Recent expansion in operations into Hawaii and other future expansion potential to the East Coast of the United States

## Airline Analysis



- American Airlines: Full-service airline
- Emerged from bankruptcy in 2013
- Based out of Fort Worth, Texas
- Greatest combination of seat availability and distance flown out of all the carriers based in the United States
- Merged with US Airways
- Increase in route network post-merger with greater coverage and interconnectivity along the East Coast



## Airline Analysis



- Delta Air Lines
  - Full-Service Airline
  - Headquarters in Atlanta, GA
- Emerged from bankruptcy in 2007
- Member of the SkyTeam global airline alliance
- Ranked as #2 in the J.D. Power North American Airline Satisfaction Study for Full Service Airlines
- To provide additional options, Delta now offers Basic Economy (even field with LCCs), Main Cabin, Delta Comfort +, Delta One, and First Class

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