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EMERGING AS A MAJOR CARRIER.

A CASE STUDY OF AMERICA WEST AIRLINES

Lawrence J. Truitt and Stanley E. Fawcett

ABSTRACT

The increasing concentration and turbulent financial environment of the U.S. airline industry raise serious questions regarding the efficacy of airline deregulation. The deregulatory experience has brought into question many of the critical assumptions of entry freedom and contestable markets upon which much of deregulation was based. The current environment poses the important question: How does a smaller or new carrier compete with today's increasingly global megacarriers? The evolution of America West Airlines in its struggle to build a strong market niche provides an interesting case study of one start-up carrier's strategies and policies.

INTRODUCTION

In the decade since the passage of the Airline Deregulation Act of 1978, the airline industry has undergone immense structural change. The original goal of air deregulation, as emphasized by deregulation's sponsors, was to make air travel more accessible to the average consumer by opening entry to the air passenger industry. However, rather than the highly competitive industry characterized by a large number of carriers offering a wide range of price/service options envisioned by deregulation's architects, the airline industry has evolved into a highly concentrated industry dominated by a few industry giants. Indeed, the top five airlines controlled 74% of the market and the top ten carriers provided 94% of domestic revenue passenger miles (RPMs) in 1988 (Secretary's Task Force, 1990, p.6). In addition, a number of U.S. carriers such as TWA, Continental, Midway, and Pan Am are in an increasingly troubled financial condition. This high level of concentration coupled with an unstable environment has caused some industry observers to predict a "traumatic period" in the 1990s characterized by another round of discounting and bankruptcies for the industry ("Airline Shakeout On Way," 1990, p. 1). Indeed, Eastern Airlines continues to operate under Chapter 11 protection. Such a

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turbulent environment poses a serious competitive dilemma for both existing smaller carriers and future entrants.

The objective of this case is, therefore, to investigate an increasingly important question: How does a smaller airline survive and grow in a highly concentrated industry dominated by a few major carriers? By briefly discussing the evolution of today's airline industry along with developing a case history of one of the more successful of the upstart carriers--America West Airlines--insight into the issue of competitive strategy in the airline industry can be gained.

INDUSTRY BACKGROUND

Government control of the airline industry began with the passage of the Civil Aeronautics Act of 1938. During the next four decades, the Civil Aeronautics Board (CAB) performed a dual role of promoting and regulating air travel. Functioning in its primary role of economic regulator, the CAB exercised control over the airline industry in three areas: entry and exit; rates and earnings; and service. Not until Kennedy's transportation message of 1962 was this principal role of the CAB seriously questioned. In this address Kennedy called for "the removal of excessive and cumbersome regulatory supervision . . . and greater reliance on the forces of competition . . ." (Sampson, Farris, & Shrock, 1985, p. 453). By early 1970 the inefficiencies and inequities of the regulatory environment led to a call for deregulation. Indeed, under regulatory control of entry and fares, the airline industry performed as an imperfect cartel, producing supracompetitive rents for airline employees, while providing only marginal returns for the airlines. At the same time, the price and service options available to the consumer were extremely limited, effectively restricting air travel to business travelers, the more affluent, and those who traveled in emergencies. Nevertheless, given the long experience of extensive economic control, the decision to deregulate the airline industry represented a significant change in regulatory philosophy. Many viewed airline deregulation as an experiment--an experiment that led many leading economists to predict either great success or dismal failure.

The success or failure of this great experiment of airline deregulation hinged on whether competition could effectively replace regulation as a control

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline over the industry; the very purpose of deregulation was to allow competitive market forces to take the place of the federal government in deciding the quality, variety, and price of domestic air service. Unfortunately, the theoretical assumptions of perfect competition, especially the requirement of a large number of sellers, have never matched the airline industry. Contestability theory was therefore promoted by the advocates of deregulation. Under the theory of contestable markets, potential entry of non-participating airlines is substituted for the existence of "a large number of sellers." For potential entry to effectively prevent existing monopoly carriers from charging higher than competitive fares, two basic conditions had to exist: first, no barriers to entry or exit could exist, and second, no economies of scale could be present. If either of these conditions failed to hold, an effective strategy of "hit-and-run" competition could not be carried out by new entrant airlines. However, the CAB ultimately determined that these conditions existed in the airline industry: "There are no structural traits inherent in domestic air transportation which indicate superior performance by large-size firms; nor are there traits which would significantly inhibit the entry of new firms into the industry" (Brenner, 1988, p. 280).

The experience of two small, specialized intrastate carriers in California (PSA) and Texas (Southwest), seemed to confirm the CAB's finding and provided practical evidence that new entrants could compete successfully with existing airlines. Neither of these carriers was subject to CAB control and both entered as low-cost airlines attempting to exploit specific market opportunities that had been neglected by trunk carriers. Taking advantage of their lower cost structures, these new entrants offered fares consistently lower than those of their larger competitors. In both cases, the result was rapid market growth and an increase in competition in the city-pair markets where these new entrants participated. These "real-life" competitive experiences provided the necessary impetus for deregulation.

THE DEREGULATED ENVIRONMENT

In the initial stages of deregulation, the airline industry performed very much as the deregulators predicted it would, with a large number of both small and large carriers entering the industry. A number of these airlines, most

notably People Express, became the darlings of the industry. This point is of interest since open entry represented the essence of deregulation. In the six years following deregulation, 26 additional airlines began scheduled interstate service; however, 19 of these withdrew service during this same time period. This entry and exit activity left a net gain of seven carriers. By way of comparison, in the forty years of regulatory control, the CAB received 79 applications to begin scheduled trunk service but granted none (Deregulation, 1985). Among the seven new entrants were such notables as America West, Midway, People Express, and the former interstate carriers PSA, and Southwest. Competition from this new breed of low-cost airlines, which used their advantageous cost structures as a competitive weapon by offering lower fares to the traveling public, forced the established carriers to offer substantial discounts to compete in the short run. By 1984, 81 percent of all passengers traveled on discount fares at an average discount of 51 percent below full fare (Deregulation, 1985). To become competitive in the long run, however, the major airlines would need to improve productivity, bringing their inflated costs into line with those of the low-cost carriers.

Other notable changes in the performance of the industry during the first 6 years of deregulation were an increase in the number of markets receiving nonstop service, an increase in flight frequency during peak times increased, and an increase in convenience, as measured by the ability to complete a flight on the same plane or the same airline, increased substantially. Further, the entrance of low-cost airlines led to the development of a wide array of "no frills" service offerings. Some examples of spartan service included all-seats-one-fare pricing, no assigned seating (first come first serve), no in-flight meals or drinks, and carry-on only flights (baggage checking available at an extra charge).

Unfortunately, the first six years of deregulation failed to bring an improvement in financial performance. Rather, the airline industry turned in its worst financial performance in history. Losses exceeded \$4 billion from 1979 to 1984, with 1982 being the worst single year in airline history. However, much of the turmoil responsible for these losses resulted from factors not related to deregulation. Specifically, rising fuel costs (almost doubling between 1978 to 1981), a severe economic recession, and a disruptive strike by the air traffic

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline controllers union contributed to the losses. Nevertheless, intense fare competition played an important role in creating the losses as many airlines priced services below cost on certain routes.

By 1984, the established carriers, such as American, Delta, and United, realized that deregulation was here to stay, and began to implement a variety of new programs designed to combat potential rivals. First, by taking advantage of the financial arrangements that have typically existed at most airports to tie up terminal gates and by buying landing slots at the nation's four busiest airport, the incumbent airlines have gained considerable control over the physical resources needed to establish a competitive presence. In fact, 68 percent of the nation's leading airports do not have open terminal space available for new entrants, and at many of these subleases can be arranged only at exorbitant rates or are tied to ground handling contracts (Dempsey, 1987, p. 542).

Second, for an airline to successfully enter a new market, it not only must presumably offer some differential advantage to potential passengers, it must also communicate that advantage to consumers. A vast amount of information concerning fares, routes, schedules, and service must be disseminated in this communication process. And in today's television-dominated society, making this information visible can be extremely expensive. For a new airline to attempt a contested entry into a hub dominated by a major airline, the task of establishing credibility as a viable carrier represents a formidable barrier since the new entrant would have no name recognition or proven track record.

Third, the major airlines have actively sought to develop economies of scope, density, and information through the development of hub-and-spoke structures and through an increase in merger activity. Hub-and-spoke route systems have several advantages over point-to-point service: an increase in the number of city-pairs that can be served efficiently by an airline, a reduction in dependency on other airline for interlining, an improvement in schedule frequency during peak hours, a higher retention rate of passenger on-line, the development of traffic feed through the hub, and the more efficient use of aircraft and personnel. Similarly, as pointed out by William Jordan, the primary benefit of recent merger activity (25 carriers were involved in 15 different

mergers in 1986) is, ". . . the market power it achieves from a route network that serves many points, thereby providing single-carrier service to an increased number of passengers" (Jordan, 1988, p. 26). The end result is that when an established carrier develops and takes advantage of these economies, it removes almost any service incentive a passenger may have to fly an upstart rival airline.

Fourth, the incumbent airlines have shown a particular adeptness at imposing switching costs throughout the distribution system. Through the implementation of frequent flyer programs for individuals, progressive commissions for travel agents, and corporate discounts for large businesses, the incumbents have greatly reduced the willingness and ability of consumers to switch carriers. In addition, the development and propagation of computer reservation systems (CRSs) by the major airlines has significantly increased their ability to influence travel agents and to monitor both the behavior of travel agents and of rival airlines using their systems.

Fifth, the majors have implemented successful yield management programs, which allow them to selectively match or beat the low fares offered by lower-cost rivals. Using computers to track travel patterns, the incumbents are better able to manage their inventory of seats. Discounts are offered only on those seats that would otherwise go empty, and even then the deepest discounts are restricted by advance purchase requirements, weekend travel, and other limitations. In effect, the airlines are using CRSs to supply information needed to successfully apply contribution or marginal-cost pricing to excess capacity. This selective approach to price matching creates the perception that incumbent airlines are price competitive with low-fare operators, effectively nullifying their low-cost advantage.

Sixth, a more recent development that has caused some alarm among public policy makers is the international marketing and financial alliances being formed between major U.S. carriers and a growing number of European airlines. The marketing alliances permit each partner to expand their route network and to act as feeders to one another.

Of even greater concern is the trend of foreign flag carriers buying stakes in U.S. airlines. For example, Scandinavian Airlines System owns 9.9%

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Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline of Continental Airline Holding, Inc. (formerly Texas Air Corporation). In addition, KLM Royal Dutch Airlines participated as a major partner in the group that purchased Northwest Orient Airlines ("Europe's Interest . . . ," 1989). Although current law limits foreign ownership of U.S. carriers to 25%, the growth of such international financial alliances has serious competitive implications that concern industry analysts and government policymakers. The inability to obtain financing for a proposed buy out of United Airlines by a partnership in 1989 has been attributed in part to comments by Secretary of Transportation Skinner. Skinner suggested that DOT was concerned because of the level of participation of British Airways in the partnership.

Finally, perhaps the most direct approach taken by the holdover airlines to meet the challenge of the deregulated environment has been to improve their competitive position vis-a-vis low-cost entrants, by bringing cost structures into line with those of their new rivals. Probably the most important changes are the result of concessions secured from labor unions including the renegotiation of labor contracts, implementation of two-tier wage structures, and acceptance of cross training programs. These changes have been particularly significant since labor costs represent the largest operating cost of the airlines -- up to 40 percent.

In summary, today's deregulated environment is hostile to potential entrants. The concentration of major air carriers exceeds that of prederegulation years when the CAB administered a federally sponsored oligopoly. The five major air carriers in 1988 controlled 74% of the industry capacity, and the two largest carriers (American and United) exceeded 32% of the market in 1988 (Secretary's Task Force, Vol. 1, p. 18). Further, by improving their ability to respond to the new price-service options offered by new entrants, incumbents have shortened the time lag between initial entry of a new competitor and their competitive response. Removing this time cushion, which is so essential to the new entrants' efforts to establish a competitive presence makes new entry much more difficult, if not impossible. When this elimination of response time is accompanied by effective marketing and pricing strategies, almost any advantage a potential entrant would have had in the initial stages of deregulation would now be effectively negated.

AMERICA WEST AIRLINES

Founded August 1, 1983, America West Airlines began operations serving five cities with three Boeing 737 aircraft, and has enjoyed fantastic growth from its Phoenix hub. America West has been referred to as a "pearl of deregulation." Today, the carrier operates a fleet of 89 Boeing aircraft, and with over \$1 billion in annual sales, was designated a major carrier in 1989 by the FAA. Further, the carrier dominates the southwest market from its Phoenix and Las Vegas hubs with more than 40% of the passengers out of Phoenix's Sky Harbor Airport flying America West. Its most active competitor in Phoenix, Southwest Airlines, has a market share about half that of America West.

Although America West has demonstrated a remarkable ability to survive and has substantially expanded its route structure by securing dominant positions at both Phoenix and Las Vegas, it has yet to show it can achieve long-term profitability. Profits were disappointing until 1989 when the carrier earned over \$20 million. However, they record a cumulative loss of \$28,432,513 through December 31, 1989 (Company Annual Reports, 1983-1989). The lion's share of this loss, \$47.5 million, occurred in 1987, the airline's single worst year in terms of financial performance. When losses continued into the first quarter of 1988 (the carrier posted a first quarter deficit of \$16.3 million), America West announced that the explosive growth of 1987 would no longer be necessary and that the carrier would focus on a return to profitability. According to Ed Beauvais, America West's Chairman:

The 1987 results were indeed very disappointing and in large measure represented the expansion costs we incurred to achieve the dominance of our two hubs, Phoenix and Las Vegas. The massive industry consolidation which occurred in 1986 and 1987 compelled America West to bulk-up its size to compete with the new breed of airline. We no longer have to repeat our explosive growth patterns of 1987.

(America West Airline Annual Report, 1987)

During the March 1988 annual meeting, Beauvais outlined his plan to return the carrier to profitability: eliminate 10% of its flights, reduce its fleet from 64 to 60 aircraft, and cut its work force from about 7200 to 6700. In late July

1988, America West announced the company had a second quarter profit of \$2.6 million and proclaimed: "We have been profitable in three of the last four months and are very confident for the remainder of 1988" (America West Airlines Annual Report, 1988). At year end, a profit of \$9.3 million was reported. This profit included a one-time gain of \$21.6 million from an exchange and repurchase of securities. Without this and other "extraordinary" items, the 1988 results would have been reported as \$12.2 million loss (America West Airline Annual Report, 1988). Nevertheless, 1988's results were such a dramatic turnaround from the record losses of 1987 that many of the same analysts who had predicted America West's failure a year earlier began predicting higher profits for 1989. Southwest Airline's Chairman Herb Kelleher called America West's reversal "extraordinary."

Indeed, as America West's profitability returned, so did its aggressive growth. Despite America West's turnaround, many challenges remain to be managed before the airline's successful future will be assured. First, America West's financial position appears to be precarious, given the turmoil the airline industry is expected to pass through in the next several years. In its year-end 1988 financial statements, America West listed debt exceeding \$500 million, with equity of \$87 million—a debt ratio exceeding 5 to 1. Interest expense on this debt was more than \$43 million, and net working capital was recorded a negative \$18.8 million at the end of 1989 (America West Airline Annual Report, 1989). This financial position troubles many observers who suggest that America West may have overextended itself as it did in 1987 and that it has no reserve of cash to meet unexpected downturns or to take advantage of new opportunities. Second, in 1985, Southwest initiated a significant expansion of service at Sky Harbor Airport. Because the two carriers compete head to head on many routes, Southwest's consistently very low fares (as low as \$24.00) in the overlapping markets has led to a "sky war" with the carriers matching each other's low fares and targeting negative advertising at the other's service. Southwest has proven to be a "thorn in America West's side" and this rivalry is expected to continue into the foreseeable future.

Finally, the airline industry remains in a very dynamic state of transition with legislation that could conceivably change the nature of industry competition

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constantly pending before Congress. While some of the suggested changes, such as the possibility that the dominant carriers will be forced to divest their CRSs might be favorable to America West, several others would pose substantial challenges to the airline's future competitive position. Perhaps the greatest of these is the suggestion that foreign airlines be allowed greater access to the U.S. market. America West's history of rapid growth, its current competitive position, and its competitive strategies will now be developed.

BUILDING A COMPETITIVE NATIONAL ROUTE STRUCTURE

America West initiated service as a "niche" carrier, defining its market as "west of the Mississippi River" and its primary hub in Phoenix (America West Airline Annual Report, 1984, p. 4). The carrier chose Phoenix as its hub for several reasons including the year-round good weather, a strong base of conventions and tourism, the proximity to California, and a perceived lack of competition. In fact, as an airline consultant, Beauvais had previously suggested to a major carrier that it establish a hub in Phoenix for these same reasons.

America West's original route structure included regional service from Phoenix to Los Angeles, Wichita, Colorado Springs, and Kansas City. With this base of operations, the company wasted little time in expanding its service to include a number of other western destinations. During the first five months, America West's route structure grew to the point that by the end of 1983 the airline offered 31 daily departures to 13 cities, utilizing 10 Boeing 737 aircraft. The carrier followed a dual approach to its choice of expansion markets: first, America West offered frequent flights to nearby major metropolitan areas such as San Diego, Los Angeles, Las Vegas; and second, the airline targeted with less frequent flights a number of smaller western and plains cities such as Des Moines and Tulsa. These smaller markets were selected because America West's management believed these cities lacked adequate service to and from Phoenix.

America West continued to develop its western strategy with rapid expansion through 1984 and 1985; by year-end 1985, America West operated 32 jet aircraft with 118 daily departures from Phoenix to 32 cities. At the same time, the carrier began to develop a secondary hub operation in Las Vegas.

expansion into Las Vegas' McCarran International Airport was an extension of their initial competitive strategy. That is, just as Beauvais had felt the existing major carriers had neglected to serve Phoenix, America West's management believed the Las Vegas market presented a potentially attractive opportunity to enhance its competitive presence in the West. Entrance into the Las Vegas market demonstrated the value of America West's strategy and showed its skill at market penetration as it rapidly became the dominant carrier at Las Vegas. As of 1987 the airline had added extensive daytime service to Las Vegas and controlled 25% of both passenger enplanements and available gate space at McCarran Airport. (America West Airline Annual Report, 1987, p. 1) This "superhub" concept, combining service to Phoenix and Las Vegas, has resulted in substantial market appeal and considerable operating economies including better aircraft utilization since Las Vegas' passengers are unique in their willingness to travel at unusual hours.

The period beginning in early 1987 also marked America West's departure from its western strategy as it began expansion to Chicago and the east coast. Citing the need to attain the "critical mass necessary to remain competitive in a consolidating industry" (America West Airline Annual Report, 1987, p. 4), Beauvais announced in early 1987 the acquisition of six Boeing 757 aircraft for long-haul service to Chicago, New York, and Baltimore. However, the start-up costs for east coast service were high, and load factors failed to reach expectations. During 1987, load factors declined from 61% to 56% ("The Last of the Upstarts . . .," 1988, p. 34. This combination contributed substantially to America West's huge 1987 loss of \$45.7 million. This combined with turmoil in the airline industry led a number of airline analysts to predict the airline's demise. By December 1987, stock prices had fallen to an all-time low of \$3.75 per share.

Consequently, America West announced on March 1, 1988, that it was cutting back operations by 10% in an effort to return the carrier to profitability. Although short lived, America West's cutbacks worked sufficiently for the carrier to post small profits for the second quarter of 1988. Taking advantage of Eastern Airline's decision to reduce western operations, Beauvais announced in

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July 1988 that America West would reintroduce service to Kansas City. By year-end the airline had returned to its growth strategy, albeit at a slower pace. During 1989, America West expanded service to the east coast and launched service to Hawaii. The bankruptcy of Eastern and the collapse of Braniff opened up several key slots at New York's LaGuardia and Washington's National airports. America West promptly won a DOT lottery for the temporary right to serve these two east coast airports. ("America West Adds Two Airports . . . ," 1989, p. C6)

The carrier applied for DOT permission to begin service to two foreign destinations -- Australia and Japan. The possibility to expand to Australia is particularly appealing to America West for two reasons, (a) Australia's Ansett Airlines owns 20% of America West's common stock, and (b) Australia's domestic airline industry is soon to undergo its own economic deregulation. These two factors, combined with the trend toward a more global economy, could have provided an opportunity for America West to channel its growth. Securing the DOT's approval to serve transpacific markets would have been a big boost to America West's future position in the industry. However, the Australian routes were ultimately awarded to American Airlines, primarily because of American's extensive domestic route system. America West has contested the awarding of the routes to American, but their prospects for obtaining routes to Australia appear dim, at least in the near term ("Australia Air Route Appealed, 1989:E10).

America West also lost in its initial bid to expand in the Pacific Basin when the Department of Transportation decided to award the Tokyo routes to Continental. America West had received the support of the DOT staff, but the law judge determined that, although America West might be an "aggressive" new competitor, it should not be "rewarded" with the route because of deficiencies in its presentation during the hearing (Continental Get's Yoder's Backing, 1990). However, the judge commented that Continental's record indicated that this carrier had its own deficiencies and recommended that America West be awarded the routes in the event that Continental is unable to launch or maintain service.

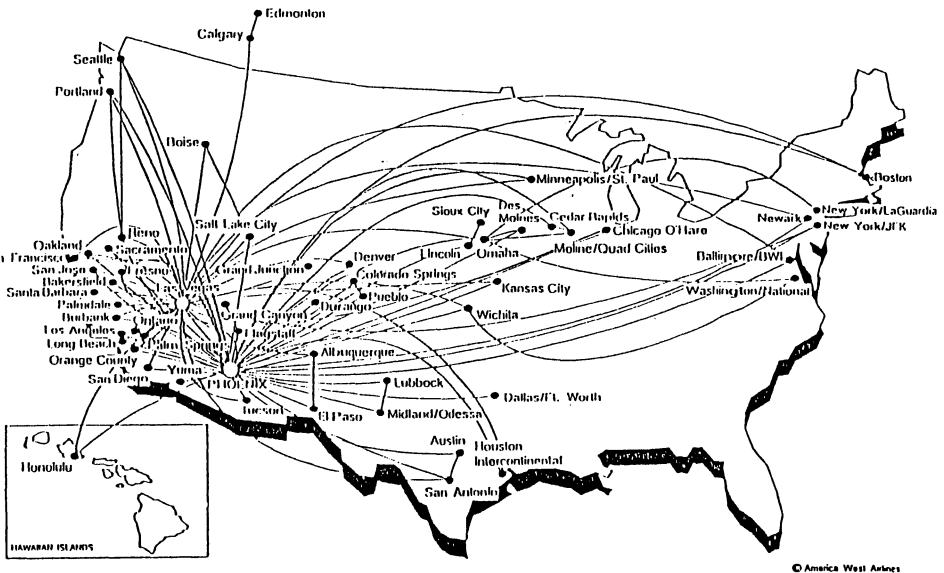
Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline
 The carrier has expressed an interest in serving other Pacific destinations

from Honolulu, including New Zealand, and has already filed applications with federal authorities to provide service to several Pacific Rim destinations including Taipei, Taiwan, Hong Kong, and Nagoya, Japan. Chairman Ed Beauvais announced the proposed additional routes at the company's annual meeting in mid 1990. Approval is expected later this year for the additional service ("America West Has Eye on Orient . . .," 1990:F1).

Speaking of America West's high expectations for its Hawaii service and Pacific region expansion, David Sylvester, formerly an airline analyst for Kidder, Peabody & Co. and now a financial executive for America West, characterized America West's Pacific plans as being fraught with risk. Sylvester noted that the carrier would incur costs of at least \$30 million to train crews and to set up the support facilities needed for the proposed Boeing 747 service and further cautioned that such expansion could put America West in a serious cash crunch if the economy weakens ("America West Flying High . . .," 1990, p. 41). The carrier's most recent route map is illustrated in Figure 1.

Figure 1

America West Routes



TARGETING A CROSS-SECTIONAL MARKET

America West identifies and actively targets the business traveler as its primary customer. The airline's policy of providing complimentary copies of the *Wall Street Journal* was initially designed to attract the business flyer. The airline's luxury lounge, the Phoenix Club at Sky Harbor Airport, is another incentive offered to attract business travelers. The club offers members a comfortable atmosphere in which to work or relax. The lounge maintains a library, complete with a personal computer and a copy machine, for use by members. As with other airlines' private clubs, America West charges an annual fee for membership. A final feature of America West's strategy to build business travel is its "FlightFUND," the airline's frequent flyer program. Members are awarded points not only for flying America West Airlines, but also for using the services of its affiliated members, including Doubletree and Marriott hotels and Dollar Rent-A-Car.

Although America West considers the frequent business traveler to be its primary market, the airline also aggressively pursues the leisure traveler--especially for destinations such as Las Vegas and San Diego. America West's low fares and frequent flight schedule provide the carrier with its principal attraction to non-business travelers. In a move to more aggressively pursue the pleasure segment, the airline entered the tour-packaging industry in December 1987 with the establishment of a new division, Ameriwest Vacations. Ameriwest offers a series of basic 3 day/2 night packages that include air transportation, ground transportation, and hotel/casino accommodations at both Reno and Las Vegas.

Ameriwest has enjoyed exceptional success by becoming the largest single-entity wholesaler in both Las Vegas and Reno. The vast majority of Ameriwest's tour business originates from Chicago and the east coast cities served by America West. Spokesperson Daphne Dicino estimates that Ameriwest utilized more than 500,000 room-nights for 1989. According to Dicino, Ameriwest Vacation's growth potential in Las Vegas and Reno is limited only by its ability to obtain hotel rooms. Tour packages are also offered to Colorado Springs and Honolulu. Now that America West has initiated service to Honolulu, Ameriwest Vacations plans extensive growth in Hawaii. To this

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline end, the carrier has negotiated an agreement with Aloha Airlines to serve the other island (Dicino, 1990). Ameriwest plans further expansion in the California cities of Los Angeles, San Diego, and San Francisco.

DEVELOPING A HIGH-QUALITY, LOW-FARE SERVICE STRATEGY

America West vigorously promotes its ability to offer passengers high-quality service at a reasonable fare. This position is evidenced by the company's promotional themes emphasizing the concept, "Less Fare. More Care." America West's service includes the usual amenities, such as assigned seating and interline baggage agreements. In addition, the airline offers a combination of in-flight services to set it apart from discount carriers. For example, America West offers passengers free copies of the *Wall Street Journal* and *USA Today* and serves complimentary top-shelf alcoholic beverages. Although it promotes its lower prices, America West has directed its efforts at offering a highly professional and quality service. The policy of offering coach passengers free cocktails differentiates America West from the rest of the industry in today's cost-conscious market.

In February, 1986, America West introduced a unique service to enhance its position in the Phoenix market. This innovation was its Careliner bus service connecting Sky Harbor Airport to a centrally located hotel in Scottsdale. The shuttle operation now operates out of a newly completed Transportation Center in downtown Scottsdale. From this new location, the airline operates a shuttle service linking several Scottsdale resorts to Sky Harbor Airport. The idea is for America West passengers to park at the Transportation Center, check their luggage, and ride to Sky Harbor Airport in an America West Careliner bus. This free service has been such a success that the airline has doubled the frequency of bus trips (every half-hour in both directions), and Scottsdale is now listed as a destination on its schedule.

A similar service designed to make travel on America West more convenient is the company's fast check drive-through check-in. This service allows passengers to park at an off-terminal location (at lower than airport costs), where they check their luggage and receive their seat assignments. Once checked in, passengers are driven to the main terminal in America West shuttle buses.

While striving to provide a high level of convenient service, America West has consistently emphasized its ability to offer low fares. Even so, the airline has sought to avoid the image of a discount carrier. Initially, all passengers paid the same low fare. This one-low-fare approach allowed America West to take advantage of its low cost structure to compete with its higher cost rivals which had suffered through three years of enormous losses. Over time, America West has adopted the industry standard of charging passengers a range of fares, depending upon load factors and restrictions. Although America West still presents itself as a low-fare airline, the company's differential pricing strategy disqualifies it from true discount-fare status. For example, in the summer of 1988, America West's one-way fare to Los Angeles from Phoenix could cost as much as \$64, while its lowest restricted fare was \$29. Thus, although America West frequently offers lower fares than many of its rivals, it follows a policy of yield management which entails charging what the market will bear for unrestricted travel (business or emergency passengers) while offering discounted fares to fill seats that would otherwise remain empty.

As is typical in the airline industry, the majority (60-70%) of America West's sales are generated through travel agencies. The airline subscribes to all of the major computer reservations systems utilized by travel agents, including American's SABRE and United's APPOLO. America West pays fees both for being listed on each CRS and for each ticket sold through the CRS vendors. This distribution disadvantage forces America West to provide high levels of customer service to travel agents. To do this, the airline employs a sales force charged with the responsibility of building relationships with travel agents. Also, in the tradition of America West's More Care service, America West has established a travel agency desk staffed with desk agents specifically trained to answer questions or solve problems for travel agents.

To supplement distribution through travel agents, America West has developed an aggressive direct marketing effort. America West's main reservations center is located at its corporate headquarters in Tempe, Arizona. The airline operates a second (satellite) reservations center in Colorado Springs and has a third center in Reno, Nevada. America West also recently announced plans to open a fourth reservations center in the Midwest ("Alaska

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline Carrier" (1989). These reservations centers handle passenger reservations for America West flights only. Passengers who require connection with other airlines are referred to travel agents. Further, given Ameriwest Vacations' success in the Las Vegas and Reno markets, America West expects to expand distribution of air service through its Ameriwest subsidiary. Because the yields generated through Ameriwest are favorable, this approach to expanding distribution promises to be an important component of the airline's product mix.

A relatively unique distribution strategy used by America West to promote certain routes and encourage first-time trial has been to mail discount coupons to prospective passengers. These coupons are targeted at households with incomes over \$30,000, with distribution based on demographics by ZIP code. One coupon mailing offered travelers a \$25 discount off a round-trip fare of at least \$100 or \$50 off a \$200 ticket. This particular coupon was good for any of America West's 41 U.S. destinations for travel during the period August 27 through December 14, 1988 (subject to blackout dates for the Thanksgiving holiday).

In another departure from industry standards, America West introduced its first Value Pack in 1987, which included 10 one-way travel coupons good for transportation between Phoenix and seven of its popular destinations: Los Angeles, Las Vegas, San Diego, Albuquerque, Ontario, Tucson, and El Paso. The Value Pack tickets were good for one full year after purchase and guaranteed a seat on any flight to each buyer who checked in at least 30 minutes before departure. The original Value Pack also included a 50% discount coupon on a round trip between any of the eight cities and New York/JFK, Baltimore/Washington, or Chicago/O'Hare. Officials at America West considered the Value Pack program an enormous success, with sales exceeding 25,000 books, generating much-needed first-quarter (1988) revenue exceeding \$7 million (Coleman, 1988).

MAKING THE MOST OF HUMAN RESOURCE

Perhaps one of the most remarkable factors contributing to the carrier's growth is its employees. Chairman Ed Beauvais takes pride in the high levels of performance of America West's extremely loyal employees, and he takes advantage of giving them credit at every opportunity. To Beauvais, effective

leadership is the ability to bring out the best in people in order to accomplish organizational goals (Beauvais, 1990). Under Beauvais' leadership, America West enjoys one of the lowest cost structures in the industry. This low cost structure is achieved primarily through America West's labor strategy, which is founded on the cross-utilization of a non-union, low-cost, but highly motivated work force.

Compared to the overall industry, America West's labor force is very productive. This high productivity is a result of a compensation package that management believes promotes unity, leading to high levels of employee motivation. When hired by the airline, each employee is required to purchase America West stock equivalent to 20% of his/her first year's base salary. Management believes that employee ownership is the key which leads to a feeling of partnership and a desire among employees to make America West succeed. This ownership status of the employees is highly touted by America West in its advertising and public-relations; in fact, employees are often referred to as the "owner-employee group" or "employees/shareholders." America West's employee compensation package also includes a profit-sharing program that distributes 15% of pretax profits among employees in the form of quarterly checks based on salary, length of service, and individual performance. Finally, the airline offers the entire work force anniversary incentive stock options.

America West's position as a low-cost, non-union airline appears secure for the near future although the 30,000 member Association of Flight Attendants (AFA) union and 40,000 member Air Line Pilots Association (ALPA) have aggressively pursued unionizing the airline. Both of these national union organizations set up offices in Phoenix during 1988, and for a time it looked as if one or both of the unionization efforts might succeed. One of America West's 736 pilots said, "The size of the airline has reached a point where you can't leave to chance things that affect the pilot group: retirement, benefits, pay schedules, and the way rules are applied," and indicated that more than 70% of the airline's pilots had signed cards calling for an election. However, in a federally sponsored election in February 1989 America West's flight attendants overwhelmingly (nearly 4 to 1) rejected representation. AFA representatives claim the election process was complicated by the fact that America West

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline categorizes most of its operational employees as cross-utilized customer service representatives (CSRs). According to federal labor statutes, only employees who spend a preponderance of their time performing a specific task (in this case, functioning as flight attendants) are allowed to vote in an election for union representation ("Union Vote Fails . . . ," 1989). America West's pilots also voted to remain independent ("Pilot Group Loses . . . ," 1989).

Throughout the unionization debate, America West waged a serious anti-union campaign, appealing to employee emotions with the argument that unionization would destroy the airline's dream of becoming a major carrier and claiming that unionization would ruin the company's close-knit family relationship. Many of the airline's employees expressed concern that unionization would force America West into bankruptcy. In a 1989 report to employees, management noted that both the AFA and ALPA were defeated by the largest margins in their respective histories. However, the unionization issue remains alive after a January 1990, ruling by the National Mediation Board which nullified the earlier vote to reject organization of the flight attendants by the AFA on procedural grounds ("America West Will Appeal . . . ," 1990).

Although America West has managed to maintain a union-free environment so far, the threat of unionization has forced changes. Originally, America West's cross-utilization plan was envisioned as a vehicle to improve flexibility, productivity, and employee morale by requiring all CSRs to perform several jobs in addition to serving as flight attendants. These tasks included baggage handling, working ticket counters, and answering telephones in the company's reservations center. After the first attempt at union organization in 1986, management allowed CSRs the opportunity to submit bids for particular jobs and schedules, based on seniority. Since that time, true cross-utilization of employees has diminished as employees with the most seniority bid for the most sought-after jobs, while those with the lowest seniority perform the less desired tasks. The efforts by the AFA and ALPA to organize have also forced America West to pay more competitive wages.

ADOPTING AN EFFICIENT APPROACH TO OPERATIONS

Given America West's initial route structure consisting primarily of short-haul traffic, especially to the major California coast cities and Las Vegas, a

decision to purchase fuel efficient aircraft was made. Boeing's 737 was determined to provide the best fit for American West's early needs. According to a recent cost study, which measured aircraft productivity in terms of the number of seat-miles flown per gallon of jet fuel consumed, this operating decision proved to be appropriate. The study (Nakano, 1988) concluded that America West's fleet was the most fuel-efficient of all major airlines in the United States (see Table 1).

Table 1

1987 Available Seat Miles per Gallon of Fuel Consumed

Rank	Airline	3rd Qtr	4th Qtr
1	America West Airlines	57.11	59.34
2	Southwest Airlines	52.77	52.09
3	Continental Airlines	50.68	57.87
4	American Airlines	49.41	49.97
5	Pan American Airlines	48.97	49.88

Note. From America West Airlines.

Of course, operating a relatively modern fleet of aircraft helps America West maintain its low cost structure. More recently, the airline reaffirmed its decision to utilize twin-engine Boeing aircraft when in 1987 America West acquired six Boeing 757s to service its longer haul routes to Chicago and the east coast. For its Honolulu service, the carrier purchased four Boeing 747s from KLM Royal Dutch Air ("America West in Highflying Sector," 1989). Service expansion in the Pacific Rim will utilize additional Boeing 747s.

The decision to utilize Boeing equipment has also helped America West keep maintenance costs low since maintenance personnel are able to specialize in servicing and maintaining a single type of aircraft. Single-sourcing also allows America West to carry a much lower parts inventory. These are

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important considerations, especially since America West moved maintenance in-house in early 1988 when it opened a new 660,000 square foot, \$45 million technical facility at Sky Harbor Airport. In addition to reductions in maintenance costs, America West expects an increase in aircraft utilization to result from in-house maintenance. According to Beauvais, "Down the line this will mean one to two airplanes we won't have to buy, and at \$25 million for 737-300, that will just about pay for the facility" ("America West Moves . . . ," 1988). Shearson Lehman Hutton analyst Helen Becker agrees that operating its own maintenance facility is a good idea, indicating that the maintenance facility is one of the major reasons to own the stock. Ms. Becker predicts that America West's revenue from non-passenger contract operations will prove to be an excellent investment for the future given the shortage of world-wide maintenance capacity due to the rapid expansion of the industry and the aging of the world's fleet ("America West in a Highflying Sector, . . . ," 1989, p. C6).

The new technical center represents the first phase of a massive building program planned by America West. The second phase has already begun with the construction of the floor for a second, larger hangar. The final phase is a much needed million-square-foot headquarters building at Sky Harbor Airport. construction will begin in 1991 to coincide with the completion of Sky Harbor's new Terminal IV. As a result of rapid expansion, America West's employees are currently scattered among 17 different buildings in the Phoenix area. In order to solve the administrative and logistics problems associated with operating out of so many locations, America West has asked the City of Phoenix to build a new corporate headquarters and lease it to the airline. In addition, the carrier has requested the city to build and lease to America West a second maintenance facility. Although negotiations continue, it appears that Phoenix will assist the airline in its growth.

America West's ability to keep its planes in the air has also helped the airline maintain high levels of efficiency and thus a low cost structure. According to Mark Coleman, Vice-President of Sales, America West enjoys one of the highest aircraft utilization rates in the industry. Using September 1988 as an example, Coleman claims that the airline's planes were in the air approximately 11 hours and 40 minutes daily, compared to an industry average

ground times and by offering flights to Las Vegas at unusual hours of the late night/early morning which are made possible by the "Nite Flight" program.

The Nite Flight program has also provided America West an opportunity to enter the air-cargo market. Using Las Vegas as a hub, the carrier has established a significant cargo traffic with cargo facilities in Phoenix, Los Angeles, and Oakland. Because cargo is moved primarily at night in order to achieve next day delivery and because it moves in excess cargo space, America West is able to use its Nite Flight program to provide airfreight service at almost no additional cost to the airline. Further, by using freight forwarders to perform ground pickup and delivery service, America West is able to focus on what it does best--providing air service. Thus, the revenues from the Cargo Division are very attractive. Cargo revenues of more than \$28 million were generated in 1989, an increase of 69% over the \$17 million recorded in 1988, and an increase of 223% over the \$8.8 million in cargo revenues for 1987 (America West Airline Annual Report, 1989, p. 8). America West's airfreight service has proven attractive to both businesses and individuals since it offers express counter-to-counter service as well as door-to-door service. For example, Dewey Brown, Jr., of Air Cargo Transit, notes that he uses America West's cargo services whenever possible because it offers more professional service than its competitors with better rates available. Clearly, America West has been successful in attracting a growing amount of air freight.

SUMMARY

At the outset, the question of how a relatively small carrier can survive and grow in an increasingly concentrating oligopoly was posed. Today's airline industry is far different than deregulation's sponsors had envisioned. There have been numerous airline failures, and several other carriers are in serious financial difficulty. Given the competitive composition of the industry, America West's record of phenomenal growth and its proven ability to penetrate its existing markets as well as successfully expand into new markets is truly a Cinderella story. The carrier's primary strategy to become one of the major players in the U.S. airline industry can be summed up in two words: *aggressive growth*. The airline is anxious to attempt similar growth in the international

Truitt and Fawcett: Emerging as a Major Carrier: A Case Study of America West Airline market. However, some suggest that America West has not focused its growth, but rather has chosen to follow a "shotgun" strategy with ventures such as Dash 8 commuter service, "Careliner" bus service, contract maintenance, and its Ameriwest Vacations tour operation. Whether America West can continue its dramatic growth in an industry increasingly dominated by "megacarriers" remains an important question. As Beauvais has stated, one point is certain, America West's future will be "extremely challenging and exciting" ("1989 Year in Review," 1990).

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