

This case brief highlights the airline industry's role in the transportation network of the United States. The standing of Delta Airlines and Northwest Airlines during regulation and deregulation and the effects of both as background to inform discussion of the recent merger of these two airlines, what this means to land use and transportation, what policy implications relate and if the Merger serves its overall intended purpose of providing better service to the traveler.

### **Regulation**

With fares fixed and their routes protected during regulation, the best way for airlines to grow profits was to fill as many seats on flights as possible. Airlines tried to compete with one another by offering frequent flights to destinations, so that customers could choose the time that best worked for them. As a result, most city pairs are connected by multiple daily flights even when flights would fly half empty. The intensive non-price competition among airlines to attract customers resulted in excessive spending that raised the airlines' costs, forcing them to turn to the Civil Aeronautics Board (CAB) and ask for fare increases. However, under CAB regulations, the airlines were required to use the profits of their trunk line service to cross-subsidize feeder routes from rural locations.

### **Deregulation**

The Airline Deregulation Act of 1978 removed many of the regulatory controls, changing the face of civil aviation in the United States. The airline industry became a market-driven industry, with customer demand determining the levels of service and price. After deregulation, unfettered free competition ushered in a new era in passenger air travel. Free-market competition was applied to the passenger side of the business in the Airline Deregulation Act of 1978. Restrictions on domestic routes and schedules were eliminated along with government controls over domestic rates. Congress mandated that domestic route and rate restrictions be phased out over four years.

There are two main differences in the unregulated environment versus the regulated environment for air passenger transportation. First, under regulation air carriers did not set their prices, the CAB did. What this meant is that air carriers competed on service and frequency rather than price, eliminating this competition. A benefit of this was the process was the ease of managing interline agreements among airlines for delayed passengers because major carriers have similar fare structures. The operations of both have to be integrated as well. A look into the history of mergers reveals that most were unsuccessful, with many acquiring airlines divesting acquired routes and newly merged lines crippled by strikes and labor strife. Employee morale, customer service and frequent-flyer programs have all suffered as a result of mergers.

### **Network: Hub & Spoke**

The major airlines "adopted" key cities as centers for their operations; these key cities served as stops for most flights, even if they were not on a direct route between two other end points. Hub-and-spoke systems decreased unit costs but created high fixed costs that required larger terminals, investments in information technology systems, and intricate revenue management systems. An airline with a hub-and-spoke system, thus, has a better chance of keeping its passengers all the way to their final destination, rather than handing them off to other carriers. What the growth of hub-and-spoke systems

meant for transportation is competition in small markets increased to support competitive service with a linear route system. Service to small communities and rural areas ultimately suffered and this outcome of deregulation negatively affected transportation to these areas.

### **The Cost of Travel**

Airline bankruptcies, aircraft safety and maintenance concerns, extensive flight delays and cancellations, volatile oil prices, and a litany of other issues have plagued the airline industry, now is currently in a state of desperation. There have been many attempts to help the airline industry get back on its feet through congressional intervention, but nothing has thus far succeeded. Airline mergers have been taking place since the airline industry was first conceived. It has only been until recently, however, that mergers among the remaining six large carriers or legacy carriers have been scrutinized, beginning with Delta-Northwest. The catalyst for “merger mania” is centered on the run-up in fuel prices

### **Analyzing the Value of Merger**

Executives from both Delta and Northwest argue that this merger is necessary for competitive reasons and little else. In addition to creating the nation’s largest airline, executives from both side believe “the new airline will be more stable and be better able to grow to meet the challenges of the future” in what they view as a highly competitive global airline industry and difficult economic environments. Post-merger Delta promises they will provide synergies that reduce operating costs by an estimated \$1 billion from costs incurred by the two firms as separate companies. The merger promises not to close airport hubs, reduce air service, or lay off large numbers of employees.

Despite these overzealous claims of essentially creating a “problem-free” airline industry, many industry observers are dubious of these claims. Many find it hard to understand how a merger can expect to decrease operating costs by a proposed \$1 billion without cutting jobs and closing hubs. The track record of airline mergers in the United States is anything but perfect with many experts saying that there will never be a successful merger. Given the past track record of mergers and despite their best efforts, there are too many competing interests in mergers that will halt any efforts toward larger airlines. Thus, the case and policy does not serve its intended purpose.

With the merger now nearly complete, the corporate headquarters has been announced. With deregulation still in effect, the ultimate goal of the merger was to cut cost and provide better service to patrons, but will unlikely be obtainable under these conditions. U.S. Airline mergers between equals or near-equals have a bad record. Changes in the regulatory environments will likely permit mergers between major airline carriers in the years to come. Experts believe that re-introduction of regulation on some level will help solve the problems that plague the airline industry today. If measures are not taken, consumers and employees stand to face extenuating problems within the airline industry that are likely to worsen.