5 The External Environment: Competition

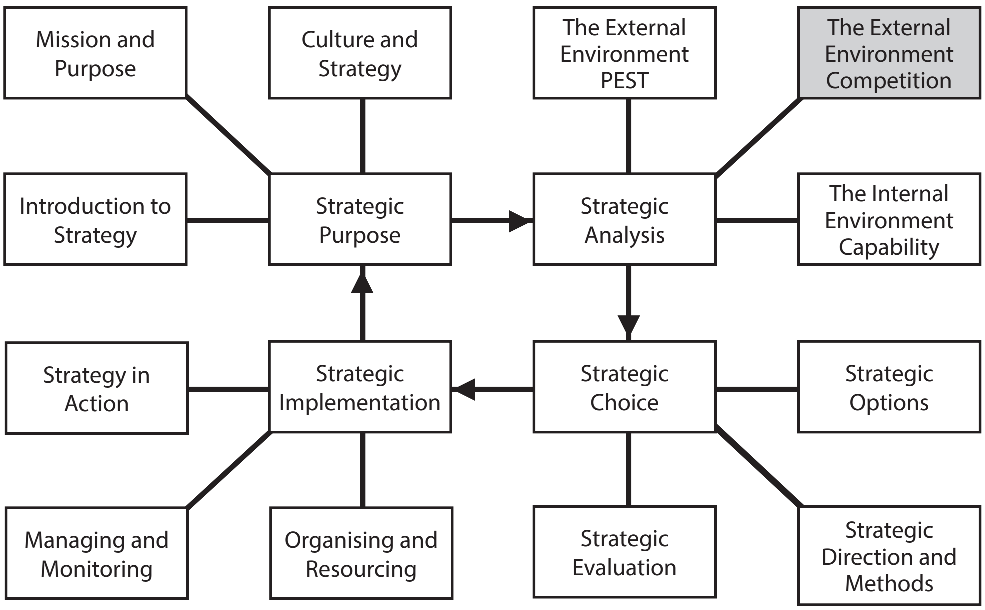

Figure 5.1

Learning outcomes

After studying this chapter and related materials you should be able to understand:

- Industries, markets and strategic groups
- Porter's five forces
- Competitor analysis
- Destination competitiveness

and critically evaluate, explain and apply the above concepts.

Introduction

Competition analysis is used to reveal the opportunities and threats that exist in the competitive environment within the tourism industry. It may be conceived of as the extent of influence of tourism organisations or destinations upon one another as well as the effects of their suppliers and buyers.

The analysis of the competitive environment which follows is divided into a number of sections. First the idea of an industry or market is examined in order to identify the competitive boundaries within which any tourism entity operates. As part of this, the concept of strategic group analysis is introduced to enable a tourism entity to identify its key competitors in specific markets. Next, techniques of competitor analysis are introduced so that profiles of key competitors can be constructed. Following this, Porter's five forces framework is used to analyse the competitive forces that act upon tourism entities. This allows a framework for competitor analysis to be introduced and finally the specifics of destination competitiveness are examined. Case study 5 illustrates these points through an analysis of the global airline business where deregulation and the arrival of low-cost carriers led to intensified competition.

Case study 5: Global Airlines

Competition in the airline industry is intense. But it hasn't always been so. For a long while the 'legacy carriers' (carriers such as British Airways, American Airlines and Lufthansa), which were founded before the deregulation of the airline markets, were protected from competition by regulation that included protective entry barriers and price agreements brokered through the International Air Transport Association (IATA). Consumer choice was limited, markets were stable and prices were relatively high.

The 1978 Airline Deregulation Act liberalised national aviation markets in the USA opening them up to competition. Subsequently the EU aviation markets were deregulated in the 1980s and 1990s and the USA and EU agreed on the Open Aviation Area in 2008. But international liberalisation is still sometimes hampered because cross-border traffic rights require bilateral air service agreements. Some national markets also remain regulated to different degrees. For example, according to Wang, Binilla and Banister (2015), China's airline deregulation was for a long while only partial because the Government wanted to protect its growing domestic market. China had wished to create strong national airlines before competing internationally. So the strategy of the Chinese government priority was one of airline consolidation and a strengthening of the "Big Three" – Air China, China Southern, and China Eastern.

Deregulation ushered in wave after wave of 'low-cost carriers' (LCCs), notably South West Airlines in the USA and Ryanair in the UK, and the airline industry was rocked by the low-cost revolution. Spring Airlines founded in 2005 was China's first low-cost carrier. Low-cost carriers offer no-frills services and relentlessly cut costs. For example Spring Airlines' employees are required to always use both sides of paper that they use and turn off lights where possible. But the low costs are passed on to consumers in low prices. Several legacy carriers set up in-house low-cost airlines to compete with low cost airlines. For example Lufthansa owns Germanwings and IAG (the parent company of British Airways) owns Vuelling. Additionally British Airways now offers fares to European destinations where checked in luggage is an extra, in an attempt to compete on price with the likes of Ryanair and easyJet.

Interestingly, China's policy towards deregulation and LCCs is becoming more relaxed. In 2013 its Aviation Administration removed the minimum pricing requirements that had prevented China's LCCs pricing their domestic air tickets below a certain level. Further changes permit new airline start-ups, expand the cap on budget airline fleets and make it easier to set up low-cost carriers by streamlining the approval procedures. The Aviation Administration has also reduced airport charges in third- and fourth-tier cities, and has pledged to encourage local government to build and adapt airports for low-cost carriers, to lower import tariffs for aircraft and aviation equipment, and to encourage lending facilities for budget carriers. This is likely to lead to an expansion of LCCs in China, and as an example China Eastern has relaunched its subsidiary China United Airlines, as a budget carrier. It plans to base itself at a new airport on the outskirts of Beijing and to triple its fleet to 80 planes by 2019.

The low-cost revolution has meant that many low-cost carriers have reported increased passenger numbers, load factors and profits, all of which have intensified competitive rivalry. These pressures have been summarised in a recent OECD report which identified three driving trends in the airline business. First, a hybridisation of business models where there is a blurring of the old distinction between full service and low cost carriers. Second, a consolidation of the industry through mergers, interlining co-operation agreements, joint ventures and alliances. And third, recurrent waves of financial distress and bankruptcies. So several legacy carriers have sometimes existed precariously on the edge of bankruptcy, and others have been forced into alliances and mergers to survive. KLM was taken over by Air France, and British Airways merged with Iberia. In the U.S., mergers of its major airlines resulted in a reduction in major competitors from eleven in 2005 to six in 2014 which now account for 94% of market share by capacity. These are Delta Air Lines, United Continental, Alaska Air Group, JetBlue Airways, Southwest Airlines and American Airlines. This concentration of power, which coincided with the earning of record profits, has led to allegations of collusion and the limiting of routes and affordable seats to keep airfares high. The OECD report also noted that three types of entry barriers continue to hinder competition in air transport markets. These are access to airport slots, airlines' loyalty schemes and drip pricing strategies.

Finally, the major Gulf carriers (Emirates Airline, Qatar Airways and Etihad Airways) are likely to become more of a competitive threat on international routes in the future. Emirates is already the largest international airline by capacity by a margin of over 30 percent compared to the second largest – United Continental. The Gulf airlines have placed record orders for new wide-body aircraft as part of their expansion strategies. Interestingly these are mainly full service airlines and benefit from being well-funded with lower fuel costs and an advantageous geographic position. The rivalry between the Gulf and U.S. airlines has led to lobbying by the latter of the U.S. administration to investigate allegations of unfair competition. It is alleged that government aid to Etihad, Emirates and Qatar Airways is being used to subsidise flights through Middle Eastern hubs to increase market share. Specific allegations suggest that the governments of the United Arab Emirates and Qatar have subsidised their airlines with more than $42 billion and that Etihad has received $14.3 billion from the government of Abu Dhabi, since 2003.

Industries, markets and strategic groups

In order for a tourism entity to understand its competitive environment it must establish the boundaries of competitive interaction. Here the terms *industry*, *markets* and *strategic groups* provide useful orientations.

Porter (1998) defined an *industry* as a group of businesses whose products are close substitutes for each other, and an industry represents the supply side of the production of goods and services. However it may provide too generalised a picture to be helpful in competitive analysis. For example, we may talk about the tourism industry but it is clear that not all participants in this industry are direct competitors.

Whilst an industry is focused on production, *markets* are focused on customers and therefore on the demand side. Markets are places where buyers come into contact with a number of sellers and are able to compare prices and products. So a market offers a finer tuning of competition boundaries. Market segmentation provides a further refinement. A market segment is a group of customers who have similar needs which can be differentiated from customer needs in other parts of the market.

It is sometimes the case that the notions of 'industry' or 'market' are too wide to allow for useful consideration of an organisation's competitive position. For example, within the UK package tour industry there is unlikely to be much competitive rivalry between China Travel Service (CTS) and Club 18–30 since their markets are segmented and distinct. It can also be the case that the level of 'an organisation' may be too generalised. For example, the interests of Merlin Entertainments encompass the diverse brands of the Legoland and Madame Tussauds, neither of which are direct competitors.

Strategic group: collection of defined suppliers who compete on a similar territory.

In cases such as these, *strategic group* analysis can be used to focus on defined business units (which may be part of a larger organisation) which compete on similar territory. The following list of characteristics may be used as a basis for establishing strategic groups which are in competition with each other.

- ◊ Pricing policy
- ◊ Quality of products
- ◊ Product range
- ◊ Extent of branding