

# Business Strategy and Competition for the Future in the Airline Industry

The business strategy theory is very useful to help aviation researchers and practitioners to make sense of the current competitive pressure under which airlines all around the world seem to be. As one of the key fields of administrative sciences, strategy can be envisioned as a hierarchy reflecting the organizational structure of multidivisional corporations in which corporate strategy states the general direction – in terms of scope and choice of business sectors – that the firm will follow, while business strategy is a formulation of how the business unit intends to compete in its given business sector. For example, Virgin is pursuing a corporate strategy of growth by unrelated diversification and has chosen to be active in business sectors such as air and rail transportation, holiday packages, music and entertainment, mobile phone communication, financial services, and “lifestyle” services. In each of these business sectors, Virgin competes by using the strength of its brand to differentiate its offerings from that of its competitors. The lower level of the hierarchy of plans reveals the instrumental character of functional strategies that are designed to support the implementation of the business and corporate strategies. Marketing strategy, human resource strategy, research and development strategy and operations strategy are examples of functional strategies.

By Isabelle Dostaler and Triant Flouris

Today, air travellers seem to be looking for carriers that are able to offer high service quality, on-time arrival, and low fares all at once. Airline companies, therefore, do not have a choice but to defy the traditional business strategy theory according to which trying to achieve low cost and differentiation simultaneously is a recipe for strategic disaster. Wishing to establish stronger conceptual and empirical links between strategy theory and aviation management practice, the authors have developed a framework that can be used by aviation researchers to (1) measure the extent to which airline companies successfully pursue the integrated cost leadership/differentiation strategy and (2) understand how they manage to resolve the trade-off between low cost and differentiation.

## Generic Competitive Strategies

Attempting to explain and categorize specific competitive strategies that firms use, Porter (1980) has argued that there exists two types of competitive advantages which can be combined with either a broad or limited competitive scope to create four well-known business strategies: cost leadership, differentiation, focused low-cost and focused differentiation (figure 1). Cost leadership is the typical business strategy pursued by companies in the consumer electronics or compact car industry. Each one of the cost leader’s value chain activities has to be conducted in the most efficient way in order to generate a profit margin despite the low prices of the product or

service offered. In contrast, differentiation is the business strategy of companies who offer a product or a service that customers perceive as being different and for which they are willing to pay a higher price. Selecting the bases of differentiation, or the features of the product and service offered or the ways in which it is offered, and developing the organizational capabilities needed to achieve the bases of differentiation is a key challenge for companies. Interestingly, in order to make sure that they offer acceptable value to customers, cost leaders must not ignore the bases of differentiation that customers value and for which they are willing to pay a premium. However, cost leaders must not try to offer features that differentiated products or services possess, for fear of being stuck in the middle. According to Porter (1980), this is what happened to Laker Airways in the 1970s. The British airline offered a successful no frill/low fare service but eventually started to add more destinations and fancier in-flight services. To maintain its profitability, Laker had to raise their fares to the point where travellers felt that they had more value for money when flying with traditional carriers. According to Porter, being stuck in the middle is a recipe for strategic mediocrity and below-average performance because pursuing all the strategies simultaneously means that a firm is not able to achieve any of them because of their inherent contradictions.

		Competitive Advantage	
		Lower Cost	Differentiation
Competitive Scope	Broad Target	Cost Leadership	Differentiation
	Narrow Target	Cost Focus	Focused Differentiation

Figure 1  
Four Competitive Strategies

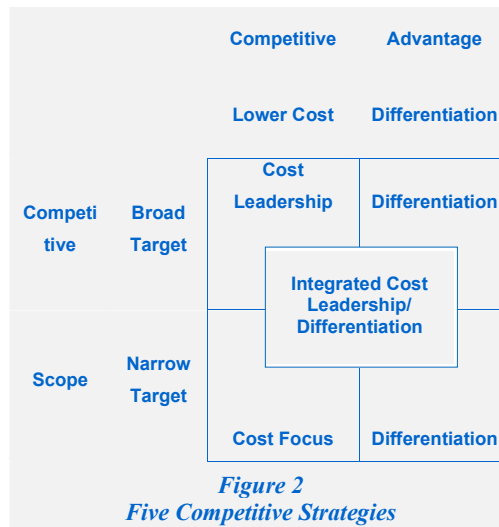
### “Stuck in the Middle” Revisited

The “stuck in the middle” prescription has generated much debate. Indeed, many authors do not consider cost leadership and differentiation as mutually exclusive and argue that companies in mature industries can rejuvenate themselves by shifting to product differentiation and innovation, whilst preserving strengths in cost reduction and process efficiency. Some researchers have observed that in many industrial sectors bases of competition in one era have become the essential prerequisites for new organizational capabilities in the next. This contributed to challenge the notion of a single competitive edge and stressed the danger for companies to pin all their hopes and resources on one main ability. This strong argument echoed the “value for money” paradigm supported by authors who advocate for the need for companies to try to achieve both cost leadership and differentiation.

Cronshaw, Davis and Kay (1994) have suggested that firms who do not establish lower costs or better or differentiated products rarely succeed overall. Interestingly, this interpretation suggested that “stuck in the middle” may be less a prescription than a way to analyse strategic outcomes and evaluate performance. The global ship building industry can be used to illustrate this. In his 1990 book The Competitive Advantage of Nations, Porter explained how Japanese, Korean, Scandinavian and Chinese ship builders have each successfully pursued one of the four competitive strategies while the Spanish and British ship building industries have declined because they were stuck in the middle. However, Cronshaw et al. argued that the weaknesses of the British yards were not due to their strategic choice but rather the implementation of the chosen competitive strategy, adding that British ship builders failed simply because they were not very good at building ships.

The “stuck in the middle” prescription should, therefore, not be taken literally. As mentioned before, Porter has insisted on the danger for a low-cost producer of not offering acceptable quality and service as well as the danger for a differentiator of having costs higher than its price

premium when he introduced his typology of business strategy in 1980. Moreover, Porter’s discussion about the sustainability of the competitive advantage in his 1990 book seemed to implicitly revisit the “stuck in the middle” prescription. The author claimed that whether a firm will be able to sustain its advantage depends on the source of the advantage, the number of distinct sources and constant improvement and upgrading. Porter made a distinction between lower-order advantages, such as low labor costs or cheap raw material, and higher-order advantages, such as proprietary process technology or product differentiation based on unique products or services; he argued that pure cost advantages are often less sustainable than differentiation. In a sense, the author appeared to treat cost leadership like the poor cousin in the competitive strategy family. The underlying message seemed to be that differentiation is the best strategy. In keeping with Cronshaw et al. (1994), it could be argued that being able to combine differentiation and cost leadership successfully would be even better. Consequently, it is not surprising that most strategy textbooks now offer a fifth choice (figure 2), namely the “integrated cost leadership/differentiation strategy,” a strategy in which an organization develops a competitive advantage by simultaneously achieving low costs and high levels of differentiation. Interestingly, while Southwest is widely recognized for having invented the low-cost carrier business model, strategy textbooks state that Southwest succeeds in spite of poor economic conditions because of its integrated cost leadership/differentiation strategy, adding that Southwest offers low fares, like many other carriers, but also has fewer customer complaints than major carriers, is able to attract employees that treat customers well and has an excellent on-time performance. Southwest, therefore, appears to achieve low cost and differentiation simultaneously.

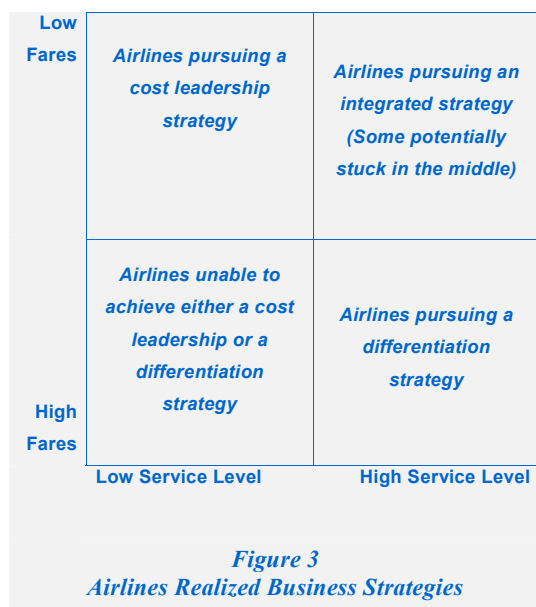


### Proposed Aviation Research Framework

Given this background, we propose a framework that aviation researchers can use to (1) measure the extent to which airline companies successfully pursue the integrated cost leadership/differentiation strategy and (2) understand how they manage to resolve the trade-off between low cost and differentiation.

Our proposed research design would first entail the identification of the business strategy that carriers actually pursue. As mentioned earlier, the typology of competitive strategies introduced by Porter can be used to compare how rivals in a given industrial sector positioned themselves. It would therefore be relevant to apply this tool to understand the positioning of a sample of airline carriers competing on the same routes (some could be traditional carriers and others could be so-called low-cost carriers). Selecting airlines competing on the same routes controls for travel distance. In fact, it can be argued that what customers value considerably depends on the length of the flight. After the sample of airlines is established, objective measurement of costs and levels of differentiation should be taken. While airline fares can be used as an indicator of the extent to which airlines are using low cost as a competitive advantage, the level of differentiation can be measured using indicators such as safety, in-flight services and on-time arrivals. Researchers can choose to concentrate on a single indicator of differentiation or to create an index using various bases of differentiation.

Published information on a carrier's performance could be used to evaluate the level of differentiation. Alternatively, direct measurement of a customer's evaluation of airline safety and in-flight services could be taken by conducting a survey of passengers travelling with the selected airlines. In keeping with Porter's typology of business strategies, this approach allows for the identification of whether or not carriers offer air travel services that passengers value and for which they would be willing to pay a premium. Moreover, measuring the fares offered by the airlines will indicate whether passengers feel that they are being offered value without having to pay a premium. Again, according to business strategy theory, this means travelling with an airline pursuing an integrated cost leadership/differentiation strategy. The expected results of the above measurement can be plotted on a scattergram (figure 3), composed of the following quadrants: a group of airlines pursuing a cost leadership strategy, a group of airlines pursuing a differentiation strategy, a group of airlines pursuing an integrated cost leadership/differentiation strategy and the last group unable to achieve either low cost or differentiation.



The next step of our analysis entails concentrating on airlines located in the integrated cost leadership/differentiation quadrant of the scattergram. Depending on whether or not all airlines in the research sample are public companies, indicators such as profit margins, stock price and return on investment can be used to evaluate financial performance. Strategic performance can be measured with indicators such as market share and capacity utilization. Measuring financial and strategic performance will allow for the distinction between airlines successfully pursuing the integrated cost leadership/differentiation strategy and airlines that are stuck in the middle and do not succeed better than those located in the bottom left quadrant of the Airlines Realized Business Strategies Scattergram.

In order to determine how airlines can manage to pursue the integrated cost leadership/differentiation strategy successfully, secondary data can be collected to compare airlines having successfully implemented the best-cost provider strategy and with airlines appearing to be stuck in the middle. It should be noted that the proposed aviation research framework does not include a priori assumptions about the factors explaining successful achievement of the integrated cost leadership/differentiation strategy. We suggest that aviation researchers compare, in an open-ended manner, the cases of airlines pursuing different business strategies and achieving different levels of financial and business performance. This could lead to the demonstration that a number of aviation strategic options exist between the traditional and low-cost airline model. Given that the airline industry is currently searching for new strategic avenues, the results of the objective comparison of airline performance and activities could be most valuable.

## References

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