

SPECIAL FEATURE

Illustrations of new entry effects on price and traffic

(See Charts 1-6 on pages following.)

As we indicated in our initial report, one of our goals is to respond to consumer input. In this regard, there has been considerable interest in markets that experienced large increases or decreases in average fares. In most instances, large changes in average fares are directly attributable to entry or exit by a low-cost carrier. In our previous reports, we included several examples of how low-fare entry and exit effected average fares and passenger levels between specific city-pairs. In this report we concentrate our analysis on recent fare and traffic changes in Providence, Rhode Island markets due to the entry of low-fare carrier Southwest Airlines. Six Providence markets appear in Table 4 with a greater than 30% decrease in average fares over the past year.

The special feature section in previous reports have shown that the introduction of low fares greatly expand the air travel market, enabling many who would otherwise not travel by air to do so. Low fares also provide competitive alternatives for many travelers who would otherwise have to pay higher fares, and often compete down the prices of incumbent carriers who previously charged much higher prices. As seen in the attached charts, this model holds true in Providence across a number of markets.

Southwest Airlines began offering service out of Providence's T.F. Green Airport on October 27, 1996.¹ The effect on average fares and passengers out of Providence was immediately evident. When our first report was published, based on third quarter 1996 data, five Providence city-pairs were in the top 1,000 markets, with 128,510 passengers travelling in those markets. By the fourth quarter of 1996, the number of top 1,000 markets out of Providence had doubled. On Table 2 of this report, 14 Providence city-pairs are in the top 1,000 markets. **Chart 1** illustrates the drop in average fares in the fourteen Providence markets that are part of the 2nd quarter 1997 top 1,000 markets, and the growth in passenger traffic that accompanied that drop. Changes in both passenger and fare levels occurred dramatically in the fourth quarter of 1996, when Southwest introduced service. Average fares have since been maintained at their new lower levels.

Charts 2 and 3 track changes in average fares and passengers per day, respectively, in the 14 Providence markets that are currently in the top 1,000 U.S. city-pairs. In order to isolate the true effect of Southwest's service on market fares and passengers, the city-pairs were broken down into two groups: those served by Southwest², and those not served by Southwest.³ Average fares dropped 47% between the 2nd quarters of 1996 and 1997 in markets served by Southwest. Over the same period, average fares dropped by 14% in markets not served by Southwest.

As shown in **Chart 3**, the 47% fare decrease in Southwest markets was accompanied by a 260% growth in passenger traffic. Non-Southwest markets also fared well, growing at a rate of 43%.

Lower fares and passenger growth in non-Southwest markets may be partially explained by consumer treatment of Baltimore as a substitute market for Washington, D.C. In addition to bringing lower fares to the markets they serve directly, low-fare competitors also influence prices in close-by, or substitute destinations. **Chart 4** illustrates the effect of Southwest's Providence-Baltimore service on the Providence-Washington, D.C. market.⁴ In spite of the fact that other direct low-fare competition was already present in this market, average fares between Providence and Washington dropped after Southwest began charging lower fares to Baltimore.

¹ Delta Express began serving Providence-Orlando at approximately the same time, and to some extent has contributed to fare effects in that market along with Southwest.

² Providence to-Baltimore, Chicago, Cleveland, Fort Lauderdale, Houston, Los Angeles, Nashville, Orlando, Phoenix, and Tampa.

³ Providence to-Atlanta, Fort Myers, Washington DC, and West Palm Beach.

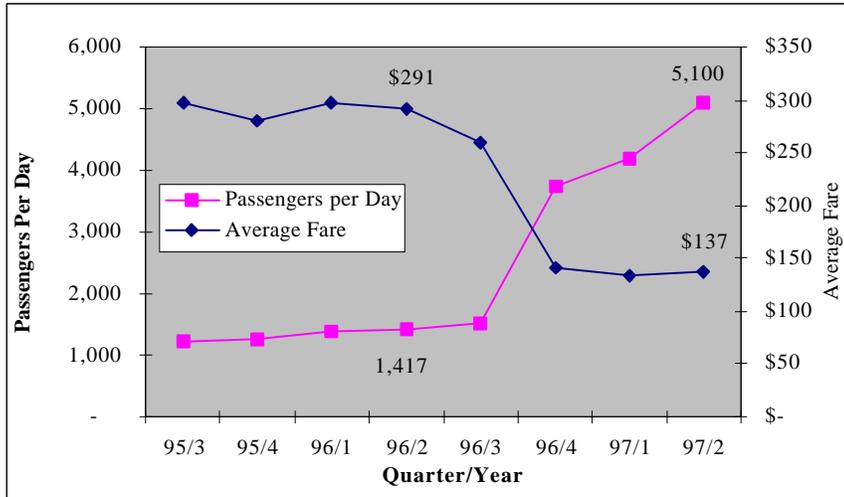
⁴ Although not examined, DOT would expect that some service to Boston would also have been affected by Southwest's Providence service.

In Table 4, Providence-Baltimore enjoyed the largest decrease in average fare, 2nd quarter 1997 over 2nd quarter 1996. **Chart 5** illustrates the 71% average fare decrease, as well as the resulting 884% increase in passenger traffic. In addition to low fares, Southwest's strong influence on this market has perhaps been due to the large amount of capacity dedicated to the market. According to the Official Airline Guide, Southwest offers eight daily nonstop flights out of Providence to Baltimore (and an additional one six days a week), more than any other carrier. Three of the five cities served nonstop by Southwest out of Providence- Baltimore, Nashville, and Chicago- experienced a greater than 30% decrease in average fares, as can be seen in Table 4.

Southwest service out of Providence also demonstrates that low fares provide incentive enough for many consumers to make some tradeoff in service levels. For example, Phoenix-Providence was the market with the fourth largest drop in average fares in Table 4. **Chart 6** shows an immediate and dramatic change in average fare and traffic levels during the fourth quarter of 1996, when Southwest first started service in the market. Southwest was able to attract customers to this market in spite of only providing flights that require either two or three stops along the way (direct), while various competitors offered single-connection flights of shorter duration. Three of the five cities (in the top 1,000) served on a connecting or multiple-stop direct basis out of Providence by Southwest- Phoenix, Houston, and Los Angeles- experienced a greater than 30% decrease in average fares, as can be seen in Table 4.

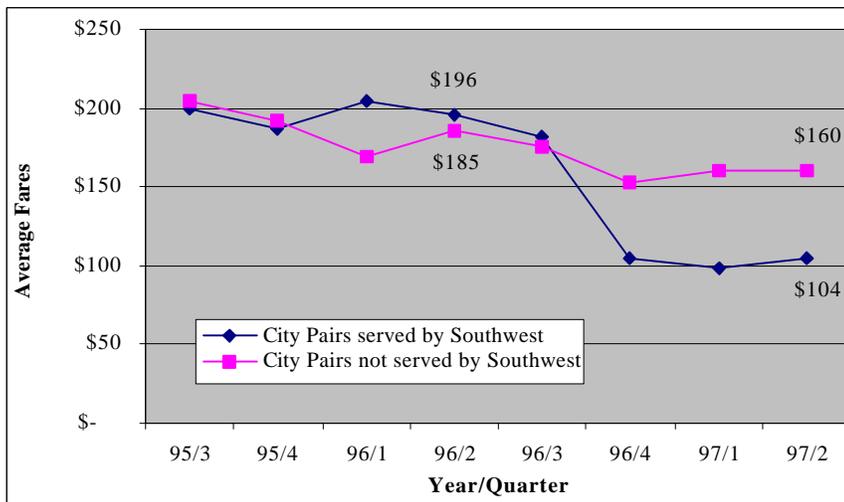
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Chart 1: Fourteen Providence Markets Currently in the Top 1,000 U.S. City Pairs



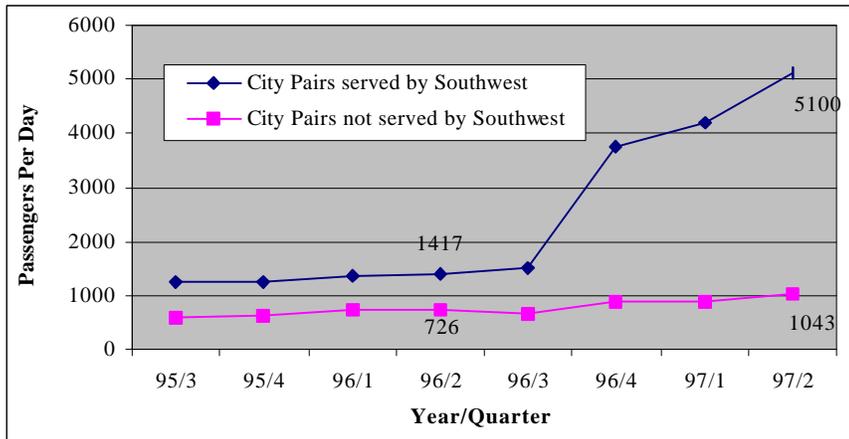
| | <u>Passengers Per Day</u> | <u>Average Fare</u> |
|----------------------|-------------------------------|-------------------------|
| 2nd Qtr 1996: | 1,417 | \$291 |
| 2nd Qtr 1997: | 5,100 | \$137 |
| % Change: | 260% | -53% |

Chart2: Average Fares Over Time in the 14 Providence Markets Currently in the Top 1,000 U.S. City Pairs



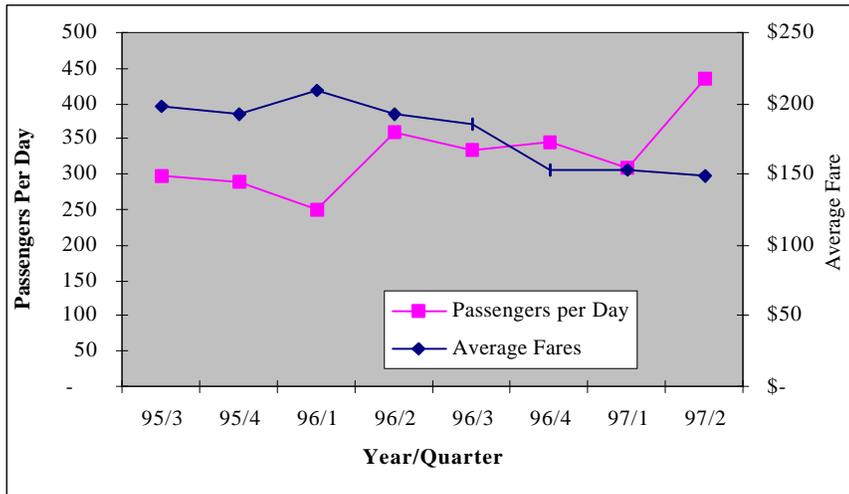
| | <u>Southwest</u> | <u>Non- Southwest</u> |
|---------------------|------------------|---------------------------|
| 2nd qtr 1996 | \$196 | \$185 |
| 2nd qtr 1997 | \$104 | \$160 |
| % change | -47% | -14% |

Chart 3: Passengers per Day over Time in Fourteen Providence Markets Currently in the Top 1,000 U.S. City Pairs



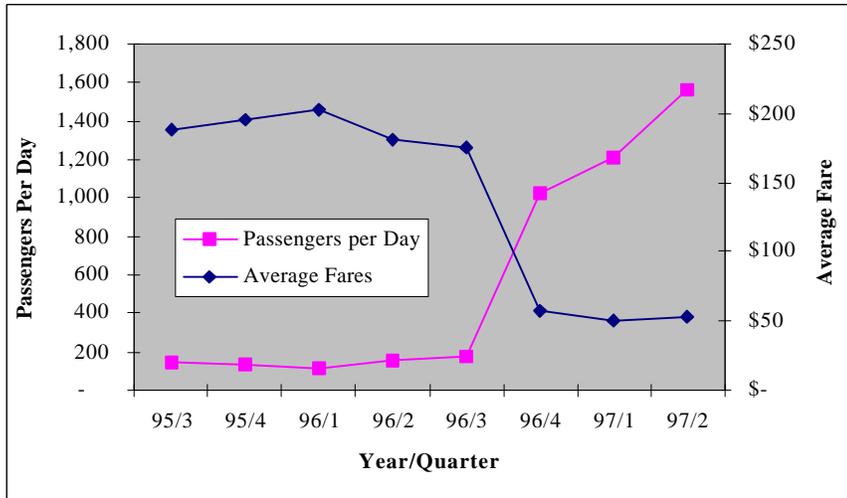
| | <u>Southwest</u> | <u>Non-Southwest</u> |
|--------------|------------------|----------------------|
| 2nd qtr 1996 | 1,417 | 726 |
| 2nd qtr 1997 | 5,100 | 1,043 |
| % change | 260% | 44% |

Chart 4: Providence to Washington, D.C.



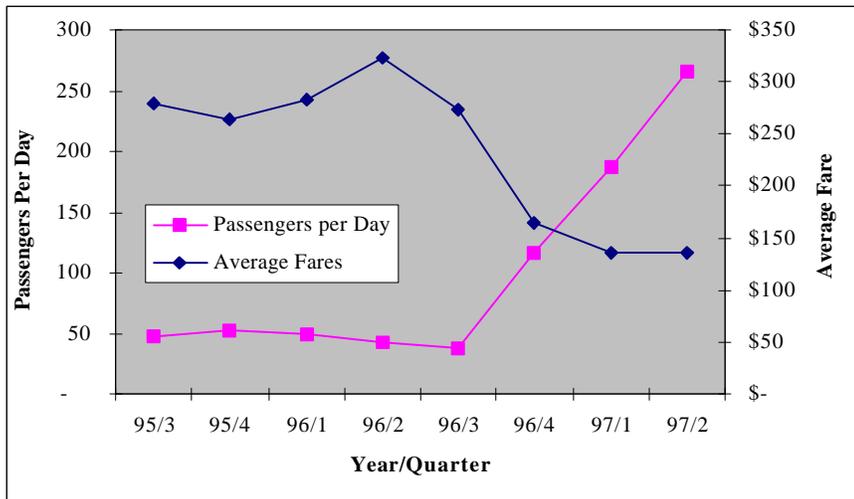
| | <u>Passengers Per Day</u> | <u>Average Fare</u> |
|--------------|---------------------------|---------------------|
| 2nd qtr 1996 | 360 | \$192 |
| 2nd qtr 1997 | 435 | \$149 |
| % change | 21% | -22% |

Chart 5: Providence to Baltimore



| | <u>Passengers Per Day</u> | <u>Average Fare</u> |
|---------------------|-------------------------------|-------------------------|
| 2nd qtr 1996 | 159 | \$181 |
| 2nd qtr 1997 | 1,564 | \$53 |
| % change | 884% | -71% |

Chart 6: Providence to Phoenix



| | <u>Passengers Per Day</u> | <u>Average Fare</u> |
|---------------------|-------------------------------|-------------------------|
| 2nd qtr 1996 | 42 | \$324 |
| 2nd qtr 1997 | 265 | \$135 |
| % change | 531% | -58% |