***Teaching Note:* Case 5 – JetBlue Airlines: Getting Over the “Blues”?**

# **Case Objectives**

1. To investigate the challenges of choosing an appropriate competitive strategy.
2. To examine how external and internal forces affect competitive strategy.

See the table below to determine where to use this case:

NOTE: There are both PRIMARY and Secondary chapters that can be used for this case. The Teaching Note gives guidance for the PRIMARY use chapters, and provides suggestions if the instructor wants to use the case to illustrate concepts from the optional Secondary chapters.

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| **Chapter Use** | **Key Concepts** | **Additional Reading and/or Exercises** |
| PRIMARY CONCEPT  5: Business-Level Strategy | Competitive strategy; generic strategies | **NOTE** embedded **video**, Neeleman, Barger interviews; optional reading, Porter, 1996, “What is Strategy?” |
| SECONDARY CONCEPTS  2: External Environment | Industry competition five forces; general environmental factors | **NOTE** web links, stock price, **video** commentary |
| 3: Internal Analysis | Value-chain analysis; resource-based view of the firm; VRIN |  |
| 4: Intellectual Assets | Intellectual and human capital |  |
| 6: Corporate-Level Strategy | Diversification; synergy; core competencies; acquisition |  |

# **Case Synopsis**

JetBlue was a domestic airline in the United States with a geographically diversified flight schedule that included both short-haul and long-haul routes. The mission of the company, according to founder David Neeleman, was “to bring humanity back to air travel,” and become America’s favorite airline. To stimulate demand, the airline focused on underserved markets and large metropolitan areas that had high average fares. JetBlue was positioned as a low-fare alternative, an airline that offered customers a differentiated product with high-quality customer service on point-to-point routes. JetBlue’s low–cost strategy was to be achieved through automated processes; better use of technology; and use of large and fuel-efficient planes. The differentiation strategy had been intended to provide a unique “JetBlue Experience” through excellent customer service, new aircraft, greater comfort (wider legroom), and entertainment through free LiveTV. With virtually no incidences of passengers being denied boarding; high completion factors (99.6 percent as compared to 98.3 percent at other major airlines); the lowest incidence of delayed, mishandled, or lost bags; and the third-lowest number of customer complaints, the company was indeed setting standards for low cost operations in the industry. The company had been voted the best domestic airline in the Conde Nast Traveler’s Readers’ Choice Awards for five consecutive years.

As JetBlue grew, it made some changes. In February 2007, JetBlue joined an alliance with Aer Lingus to facilitate easy transfers to both airlines’ customers, and signed a code-share agreement with Cape Air for service to Cape Cod. In 2008, Germany’s Lufthansa acquired a minority equity stake in JetBlue, with details of any code-share or other agreements undisclosed. In 2011, JetBlue announced an interline agreement with Virgin Atlantic that allowed passengers to connect through selected U.S. cities to airports in England and Scotland, and by 2014 JetBlue had code-share agreements with Qatar, Emirates, Korean Air, AirChina, Indian carrier Jet Airways, Eithad Airways, and El Al Israel. However, high fuel prices, the competitive pricing environment, and other cost increases were making it increasingly difficult to fund JetBlue’s growth profitability. For instance, JetBlue had introduced a new type of aircraft, the Embraer, which complicated its maintenance operation, adding costs. In 2005, JetBlue had suffered its first losses since its IPO in 2002. Losses continued through 2008, with profitability finally returning in 2009, and remaining so through 2014.

This turnaround was welcome. A disastrous storm on Valentine’s Day 2007 had exposed many weaknesses in JetBlue’s operations and had a negative impact on the airlines’ reputation as well as its financial performance. Founder and CEO David Neeleman had made a public apology and published JetBlue’s Customer Bill of Rights in an attempt to restore customer confidence. However, in May 2007, Neeleman was replaced as CEO by president Dave Barger. Barger had to pay attention to costs, and reduce capital expenditures in areas such as new airplanes, but in 2012 he initiated moves to update the Airbus fleet and purchase new aircraft as the airline continued to add routes. By 2014 JetBlue’s low-fare business model was being threatened as its costs continued to go up.

Then, in 2014, the JetBlue board asked Dave Barger to step down to allow JetBlue’s current president, Robin Hayes, to replace him. During Barger’s tenure, JetBlue was known for its customer service, but operating margins had continued to be among the lowest of the U.S. carriers. Analysts viewed Barger’s concern for customer service as counter to the needs of the stockholders, so the promotion of Hayes seemed to signal to shareholders that the airline was ready to focus on investor-friendly changes. Given that the airline had been founded on a promise to be a low-fare airline that offered customers a differentiated product with high-quality customer service, could this promise still hold? Would the needs of JetBlue loyal customers still be met? Was JetBlue moving away from its original strategy?

The answer appeared to be “yes”, as JetBlue was becoming a “hybrid carrier” model, in a niche positioned between the ultra-low-cost and full-service network air carriers. By concentrating on markets where it could become the top carrier, JetBlue was acting more and more like the big carriers it once set out to disrupt. Will JetBlue still become what it was envisaged to be, “America’s Favorite Airline”? Or, with too many complexities being introduced into its simple model of success, will JetBlue sink into the blues once again?

# **Teaching Plan**

The JetBlue case is a good example of how a firm can struggle to formulate and sustain a competitive strategy. It also provides an opportunity to discuss how the external environment and internal resources either support or challenge a firm’s choice of strategy – that strategic formulation should not be done without a full strategic analysis. Therefore, this case can be positioned in the early part of the course, just after introduction and discussion of the components of strategic analysis.

The instructor can also position this case discussion with a sole PRIMARY focus on Chapter 5: Business-Level Strategy, contrasting JetBlue to the Southest and Emirates cases – in discussing choice of competitive strategy, students are encouraged to choose between low-cost leadership and differentiation, but in the airline industry there is really no choice but competition based on controlling costs. Although students may try to explain how service amenities and features such as leather seats can create a differentiated advantage, customers rarely are willing to pay a premium for these things. This means the differences between carriers’ success often revolve around operational choices and strategic implementation. Uncovering those sometimes subtle differences between airlines can be a challenging yet fruitful discussion.

The instructor can also position this case discussion as a direct contrast to the Southwest case – the Southwest story points out how careful attention to operational components is critical to the effective implementation of a competitive strategy. The customer service differentiation advantage touted by JetBlue may be misleading. In comparison to Southwest, for instance, many Southwest customers (and JetBlue customers), and maybe some students, are loyal fans of these airlines, they believe, not so much because of their low-costs, but because of their customer service experiences. It might be interesting to students that Southwest does NOT base its competitive strategy on creating this unique customer service culture – the point is not to differentiate itself from its competitors based on how the customer values the experience, but on being able to DELIVER that experience as cheaply as possible – that’s how Southwest had been able to achieve profitability for 44 straight years!

For *advanced students*, the instructor may wish to assign Michael Porter’s 1996 article “What is Strategy?” (*Harvard Business Review,* November-December, pp. 60-79) as companion reading to the case. Southwest is used as an example in this article of how tight linkages across its value chain activities give it a valuable, rare, in-imitable, and non-substitutable competitive advantage.

# **Summary of Discussion Questions**

Here is a list of the suggested discussion questions. You can decide which questions to assign, and also which additional readings or exercises to include to augment each discussion. Refer back to the Case Objectives Table to identify any additional readings and/or exercises so they can be assigned in advance.

1. PRIMARY QUESTION: What are the components of JetBlue’s competitive advantage, and what are the merits and demerits of these components?
2. SECONDARY QUESTIONS: What are key forces in the general and industry environments that affect JetBlue’s choice of strategy?
3. What internal resources and assets does JetBlue have that may give it a competitive advantage?
4. Is JetBlue’s competitive advantage sustainable?

# **Discussion Questions and Responses**

1. ***What are the components of JetBlue’s competitive advantage, and what are the merits and demerits of these components?***

**Referencing Chapter 5: Business-Level Strategy**

How firms compete with each other and how they attain and sustain competitive advantages go to the heart of strategic management. In short, the key issue becomes: why do some firms outperform others and enjoy such advantages over time? The viability of a firm’s success is driven by both the internal operations of the firm and the desires and preferences of the market. Firms that succeed have the appropriate resources and cost structure to meet the needs of the industry and general environment.

They also have a strategy…

A *business-level strategy* is a strategy designed for a firm or a division of the firm that competes within a single business. Within the firm’s industry environment *generic strategies* include basic types of business-level strategies based on breadth of target market (industry wide versus narrow market segment) and type of competitive advantage (low-cost versus uniqueness). Here are the three *generic strategies* that are used to overcome industry forces and achieve a competitive advantage:

* Overall cost leadership
  + Low-cost-position relative to a firm’s peers
  + Manage relationships throughout the entire value chain
* Differentiation
  + Create products and/or services that are unique and valued
  + Non-price attributes for which customers will pay a premium
* Focus strategy
  + Narrow product lines, buyer segments, or targeted geographic markets
  + Attain advantages either through differentiation or cost leadership

Generic strategies are plotted on two dimensions: competitive advantage and strategic target. The overall cost leadership and differentiation strategies strive to attain advantages industry wide, while focusers have a narrow target market in mind. Both casual observation and research supports the notion that firms that identify with one or more of the forms of competitive advantage outperform those that do not.

In order to achieve a sustainable competitive advantage, JetBlue had to assess its ability to contend with other airlines. The two bases of JetBlue’s competitive advantage were *cost leadership* and *differentiation*. Therefore, JetBlue chose a combined strategy.

JetBlue achieved cost leadership by attaining efficient operations. New planes minimized maintenance and fuel costs, larger planes ensured more revenue per flight, longer hauls on an average as compared to other point-to-point services keep planes longer in air. No meals served helped quicker turnarounds and reduce costs.

However, JetBlue needed to be careful. Firms pursuing low-cost strategy generally get trapped in focusing on too few of value chain activities, or lack parity on differentiation with competitors. The low-cost advantage also gets eroded when the competitive pricing information becomes available more easily. The strategy can be imitated too easily.

The other component of JetBlue’s strategy is differentiation. This is based on creating differences in the firm’s product or service offering by creating something that is perceived *industry wide* as unique and valued by customers. Firms may differentiate themselves in both primary and support activities (see the value chain discussion to follow). Firms achieve and sustain differentiation advantages and attain above-average performance when their price premiums exceed the extra costs incurred in being unique. In JetBlue’s case, differentiation is achieved through a strong brand image, the various features including entertainment through *LiveTV* and comfort due to more legroom.

The problem with differentiation strategy is that differentiating features could be easily imitated. Firms may also get entrapped in too much differentiation, which customers may not value.

Firms employing combination strategies should have a much stronger strategy to outperform rivals. They can achieve superior performance by successfully integrating low-cost operations with differentiation, thereby avoiding the pitfalls of either of the strategies.

JetBlue employed a combination of these two strategies that, if successfully implemented, could give it a distinctive competitive advantage. It combined low-cost services with a differentiated offering. The company invested in technology for efficient operations right from its inception and, therefore, was able to provide high quality services at low-cost. Going forward, the extent to which JetBlue can maintain this integration of low-cost and differentiation will determine whether its competitive advantage is sustainable. The mutually reinforcing components of JetBlue’s strategy are critical to assess. Any change in one of the components has an impact on all interconnected activities.

Currently, the key activity appears to be JetBlue’s degree of differentiated service. The only current differentiators JetBlue have are the *LiveTV* and inflight social networking, the extra legroom, and the new planes with leather seats. These are all easy for other airlines to imitate. It remains to be seen if customers will perceive these services valuable enough to pay the premium of $20, for instance, for extra legroom, and $7 for a pillow and blanket. JetBlue had prided itself on being able to deliver these differentiated service elements, while also paying attention to costs. In order to succeed, however, JetBlue needed to achieve competitive parity on both fronts.

As explained in the chapter, *competitive parity* means a firm’s achievement of similarity or being “on par” with competitors with respect to low-cost, differentiation, or other strategic product characteristics. Competitive parity on the basis of differentiation permits the cost leader to translate cost advantages directly into higher profits than competitors. Thus, the cost leader earns above-average returns. A business that strives for a low-cost advantage must attain an **absolute** cost advantage relative to its rivals. This is typically accomplished by offering a no-frills product or service to a broad target market using standardization to derive the greatest benefits from economies of scale and experience. However such a strategy may fail if the firm is unable to attain parity on important dimensions of differentiation such as quick responses to customer requests for services or design changes. On the other hand, for those firms that choose differentiation, parity on cost requires that differentiators must integrate operations at multiple points along the value chain, reducing costs in all areas that do not affect differentiation.

Instructors can ask students if it’s possible to compete on differentiation in the airline industry. In discussing choice of competitive strategy, students are encouraged to choose between low-cost leadership and differentiation, but in the airline industry there is really no choice but competition based on controlling costs. Although students may try to explain how service amenities and features such as leather seats can create a differentiated advantage, customers rarely are willing to pay a premium for these things. It’s not enough just to be different. A differentiation strategy must provide unique bundles of products and/or services that customers value highly. Firms may also strive for quality of service that is higher than customers desire, thus they become vulnerable to competitors who provide an appropriate level of quality at a lower price. This means the differences between airline carriers’ success often revolve around operational choices and strategic implementation.

Although it might seem reasonable to pick one of the generic strategies and proceed, a firm’s competitive strategy is also dependent on both the external forces it faces and the internal resources available to it. JetBlue needs to do an analysis of both the general and industry environment to see where opportunities may exist and where challenges might lie. In the airline industry, as already mentioned, there are several challenges inherent in the industry structure that JetBlue must contend with. In addition, competitive strategy is linked to the value chain, and supported by intangible assets. JetBlue has some operational strengths in its activities, and possible social capital through its alliance relationships. These activities and assets might allow JetBlue to offer services that are unique and valuable to customers, but the costs to deliver these services must be carefully considered.

1. ***What are key forces in the general and industry environments that affect JetBlue’s choice of strategy?***

**Referencing Chapter 2: Analyzing the External Environment of the Firm**

Organizational leaders must become aware of factors in the overall environment that might affect their ability to create a competitive advantage. So how do managers become environmentally aware? By doing scanning, monitoring, and gathering competitive intelligence, and using these inputs to develop forecasts. This prepares the firm to do more extensive analysis of the forces in the general environment and the industry or competitive environment.

Environmental scanning involves surveillance of a firm’s external environment to predict environmental changes and detect changes already under way. It is a BIG PICTURE viewpoint of the industry/competition, looking for key indicators of emerging trends – what catches your eye? Alerts the firm to critical trends before changes have developed a discernible pattern and before competitors recognize them.

Environmental monitoring is a firm’s analysis of the external environment that tracks the evolution of environmental trends, sequences of events, or streams of activities. Leaders need to monitor the trends that have the potential to change the competitive landscape – what do you want to track? Firms need to CHOOSE the trends identified via the scanning activity, and regularly monitor or track these specific trends to evaluate the impact of these trends on their strategy process

What factors or trends might be most important to JetBlue? To assess how the*external environment*might affect JetBlue’s strategy, it’s necessary to take a look at the factors in the *general external environment*. JetBlue must consider the political/legal, economic and global, sociocultural and demographic, and technological forces that might affect the ability of the firm to deliver its service and sustain its business.

*Political-Legal:* Under the legal factors, the deregulation of the airline industry in 1978 provided an opportunity to several players to enter the market. It allowed new market segments such as that of the low cost, point-to-point services to emerge. It thus changed the industry landscape. Also, the bankruptcy laws had a significant role to play as they allowed even non-profitable operators to continue in the industry when they were protected. One major change that affected the low-cost carriers such as Southwest was the expiration of the Wright Amendment, which now allowed airlines operating out of Dallas Love Field to offer unrestricted non-stop flights to destinations in Texas and elsewhere.

*Economic:* The airline industry is susceptible to upturns and downturns with the trends in the economy. A growing economy and booming business mean greater demand for air travel, and a slow-down in the economy means reduced demand, consequent unutilized capacity and intensified competition. The availability of venture capital, and other capital sources have an impact on the number of new entrants into the industry. Interest rate fluctuations have an impact on the cost of operations for companies that have high levels of debt. Moreover, JetBlue’s example shows that severe weather can have a major influence on airline profits and ultimately also its brand image. Furthermore, wars with other nations and increases in fuel prices strongly impact the air industry.

*Sociocultural:* The airline industry is highly susceptible to the extreme events such as the September 11, 2001 attacks on the World Trade Center, and publicity surrounding any air accidents. These create fears in the minds of customers toward air travel and have a severe adverse impact on the industry. It also means increased security concerns, delayed flights, increased turnaround times - all these have an impact on customer perception of value, and therefore affect airline profitability.

*Technological:*  The emergence of Internet technology and other breakthroughs have had an impact on the way the airlines conduct their businesses. For example, the Internet reduced the dependence on ticketing agents. Most of the low-fare airlines sell tickets through their websites. Customer service is being extended by personnel working from their homes. All these have made it possible to reduce the costs of operations making it favorable for the low-cost airlines to operate. Also, with the Internet, customers now search and compare prices of air tickets much more easily than earlier and this accentuates the price competition.

It’s also necessary to assess the segments of the external competitive environment that include competitors, customers, and suppliers, substitutes and new entrants. Porter’s *five-forces model* allows strategists to anticipate where the industry might be most vulnerable. Help students apply Porter’s ***Five Forces of Competition*** to the airline industry by drawing a diagram on the board similar to the following, and having students fill in the details:

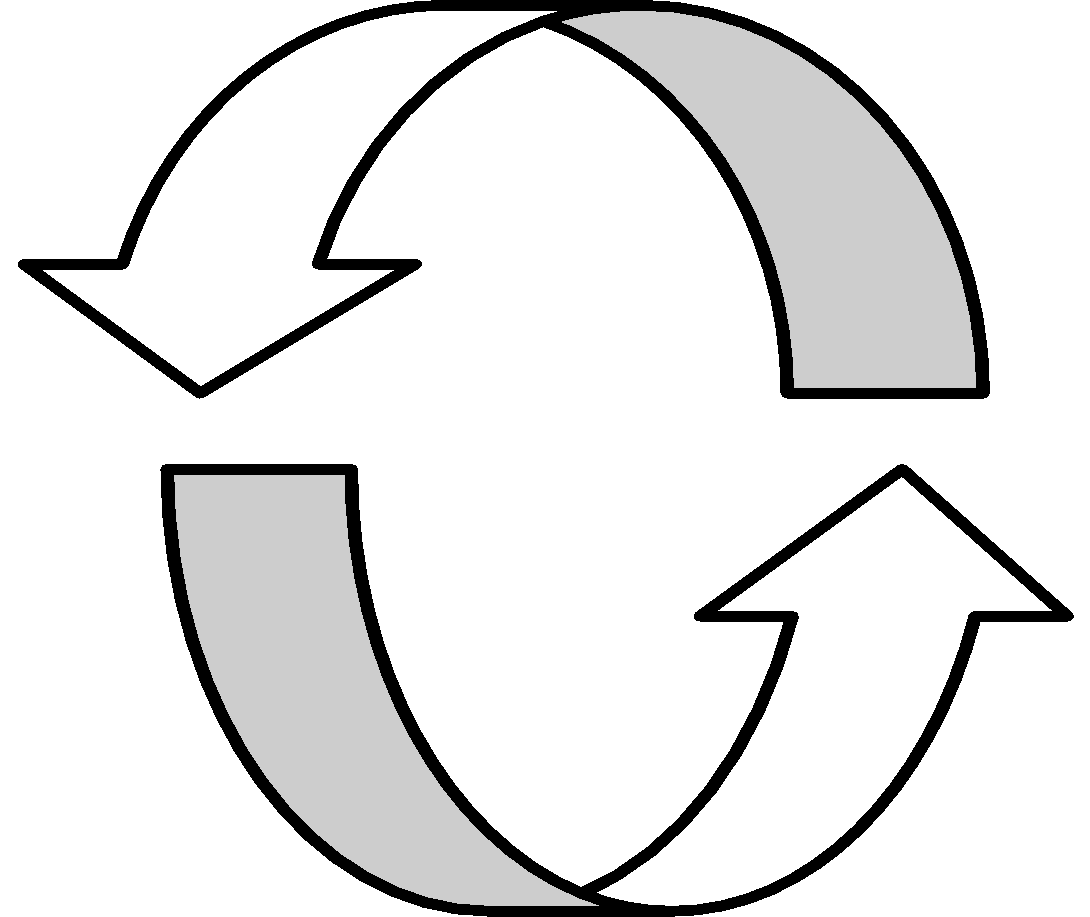
























Based on the external environmental factor analysis, the airline industry has many competitors trying to carve out a piece of the “profit” pie. Here are some details:

*Threat of new entrants*: The extent of threat due to new entrants is determined by how high or low are the barriers to entry into an industry. In the airline industry, deregulation and availability of alternate sources of funding reduced the barriers to entry.

Economies of scale. This did not work out well for the players in the airline industry. The hub-and-spoke model developed by the major players, led to more of diseconomies of scale than economies. However, the large investments already made by the major airlines, and their established networks do pose a significant threat to new entrants unless they counter it with highly efficient operations.

Product differentiation. Airlines try to create strong brand identification and customer loyalty by using the frequent flyer programs. When there is strong brand identification, it forces the new entrants to spend heavily on weaning away customers from the existing players, thus discouraging their entry. However, in the airline industry the brand identification has not proved to be so strong as to prevent people from switching to other airlines. Some low-cost players are trying to achieve some product differentiation (e.g., JetBlue providing more legroom, LiveTV at each seat, etc., Southwest emphasizing commitment to customer service). However, these are not very strong barriers to entry as the other entrants are imitating them rather easily.

Switching costs. There are virtually no switching costs for customers. The frequent flier programs attempt to create switching costs. However, when the customers are presented with low-cost options, there is nothing strong enough that could prevent them from switching to other airlines.

Thus, the airline industry faces a high threat of new entrants particularly in the low-cost segment. The barriers can be heightened only when they have very closely tied and ultra-efficient operating routines that competitors find it difficult to copy or imitate.

*Bargaining power of suppliers* is high when there are few suppliers in the industry, there are no easy substitutes to supplier’s products, when the buyer industry is not an important customer of the supplier group, the supplier’s product is an important input to the buyer’s business, the supplier products are differentiated or built up switching costs, or the supplier group poses a credible threat of forward integration. There are only two major suppliers i.e., Boeing and Airbus, to the industry and when the airline trains its pilots on either Boeing or Airbus, switching costs get built in terms of pilots’ training in the event the airline decides to change the supplier. Thus the supplier does enjoy considerable bargaining power. However, there is no credible threat of forward integration by the suppliers such as Boeing or Airbus.

*Bargaining power of buyers*is low as the buyers are not concentrated. While the buyer does not have any switching costs, and there are several choices available, they still lack concentration. Internet impacted in increasing the buyer bargaining power because the buyers can compare the prices more easily and in view of no switching costs, they could choose whichever airline offers a low price. Thus, the buyers may be able to influence the airlines to reduce their prices over time. There is no threat of backward integration from the buyers.

*Threat from substitutes*is high when the distances traveled are shorter. In such cases, the customer can choose to travel by land, by car/limo/bus/rail as they might prove to be cheaper alternatives. However, for longer distances and for more hurried customers, the airlines do not face significant threat from substitute modes of travel.

*The intensity of rivalry among existing competitors* in the airline industry is very high. There are numerous competitors, and in times of low or moderate industry growth, the competition gets fiercer as each one tries to nab customers from the other in order to keep their capacity utilizations at acceptable levels. The exit barriers are high because it is difficult to dispose off grounded planes, as there would be few buyers. Also, due to the bankruptcy laws, even the loss-making companies might still be around for a long time thus intensifying competition. So, it is easier to get into the industry but might be difficult to get out. The only solution for many companies is to merge, which is why there has been so much consolidation in this industry over the years.

In addition, as described in the case, there were traditionally three segments to the U.S. airline industry: major airlines such as the legacy carriers American, United and Delta, regional airlines such as Sky West (based in Utah) and Cape Air (out of Barnstable, MA), and low-fare carriers such as Southwest, Virgin America and Allegiant Air. Although JetBlue is identified as a low-fare airline, the external environmental shifts in recent years meant the legacy carriers could provide innovative offerings similar to those of low-cost airlines while still maintaining their alliances with regional carriers. The gap between low-cost airlines and the traditional network-based carriers was diminishing rapidly. JetBlue was caught in this squeeze, forcing it to evaluate its operational decisions even more carefully.

(See <http://www.investopedia.com/features/industryhandbook/airline.asp> for one source of information on the industry.)

**NOTE – ADDITIONAL WEB LINKS TO FINANCIAL DATA AND COMMENTARY, INCLUDING VIDEO:**

Use the tools available at this link to identify JetBlue’s stock price fluctuations over the last 5 years, compared to competitor Southwest Airlines: [http://finance.yahoo.com/q/bc?t=5y&s=JBLU&l=on&z=l&q=l&c=luv](http://finance.yahoo.com/q?s=JBLU)

More comparison between JetBlue and Southwest in early 2009 shows both airlines struggling:

<http://www.centreforaviation.com/news/2009/06/08/jetblues-unit-revenue-icestorm-southwests-prasm-tailspin/page1>

And although JetBlue did post a rare first quarter profit in 2009, JetBlue said it is being helped by lower fuel expenses, capacity reductions and new revenue from services such as charging for a second checked bag, rather than from increased passenger traffic:

<http://blogs.wsj.com/middleseat/2009/04/24/jetblue-posts-a-profit-two-carriers-stumble/>

Some analysts liken the airline industry in 2009 to the automobile industry, calling both a “meltdown”:

<http://www.thestreet.com/story/10514020/1/meltdown-101-will-airlines-go-bankrupt.html>

From the customer’s perspective, the carriers’ cost concerns and consolidation in the industry have eroded expectations of customer service. From an analysis in 2015, the airlines with the highest profit margins also have the lowest customer service scores, implying that “the more an airline earns, the less it cares about service… The highest rated airline, JetBlue, with a customer service score of 81, had an operating margin of 9 percent,” says Kevin Mitchell, whose Business Travel Coalition advocates for corporate travelers. “The lowest rated, Spirit, with a score of 54, had an operating margin of 19 percent.” Some carriers, such as Southwest, Alaska, and, recently, Delta, have managed to keep profits up while also earning good customer service ratings. The key, it seems, is what airlines DO with the profits they earn. See <http://fortune.com/2015/06/09/airline-profits-are-soaring-but-its-not-good-news-for-consumers/>

What does all this say about the industry, and JetBlue?

Regarding the airline industry, a 2007 article at The Motley Fool <http://www.fool.com/investing/general/2007/06/15/remove-that-clothespin-from-your-nose.aspx> said “Even Warren Buffett is skeptical about making money in airlines (he should know from his experience with USAir). In a 2002 interview he was famously quoted as saying:

If a capitalist had been present at Kitty Hawk back in the early 1900s, he should have shot Orville Wright. He would have saved his progeny money. But seriously, the airline business has been extraordinary. It has eaten up capital over the past century like almost no other business because people seem to keep coming back to it and putting fresh money in.  
  
You've got huge fixed costs, you've got strong labor unions, and you've got commodity pricing. That is not a great recipe for success. I have an 800 number now that I call if I get the urge to buy an airline stock. I call at 2 in the morning and I say: 'My name is Warren, and I'm an aeroholic.' And then they talk me down.”

Given the above, and the fact that it’s fairly easy to start up an airline, but hard to consistently make money at it, what might be a good competitive strategy for JetBlue to adopt going forward?

1. ***What internal resources and assets does JetBlue have that may give it a competitive advantage?***

**Referencing Chapter 3: Analyzing the Internal Environment of the Firm**

When one firm outperforms others by a wide margin over a long period of time, it’s important to figure out how this could be. The answer may lie in how that firm arranges its activities and creates unique bundles of resources that allow it to sustain a competitive advantage. Students should assess the relationships between the elements in JetBlue’s *value chain*.

Remember, value-chain analysis is a strategic analysis of an organization that uses value-creating activities. Value is the amount that buyers are willing to pay for what a firm provides them and is measured by total revenue, a reflection of the price a firm’s product commands, and the quantity it can sell. A firm is profitable when the value it receives exceeds the total costs involved in creating its product or service. Creating value for buyers that exceeds the costs of production (i.e. margin) is a key concept used in analyzing a firm’s competitive position.

Every activity should add value. Take a look at Exhibit 3.1 to see the value chain activities. Based on the relationships between these elements, JetBlue can make a choice of how to proceed to craft a competitive advantage. See the following suggestions:

|  |  |
| --- | --- |
| **Value chain activity** | **How does JetBlue create value for the customer?** |
| **Primary:** |  |
| Inbound logistics (distribution facilities, material control systems, warehouse layouts) | Web-based booking gives greater control on managing seat sales. Customers won’t get bumped. |
| Operations (efficient workflow design, quality control systems) | Paperless cockpit, no meals served, no paper tickets--all reduce time and costs. |
| Outbound logistics (consolidation of goods, efficient scheduling, finished goods processing) | New A320s are larger and more fuel-efficient. Less congested airports help quicker and on-time flight departures. |
| Marketing and Sales (motivated sales people, innovative advertising & promotion, effective pricing, proper ID of customer segments & distribution channels) | Web-based ticketing as a distribution channel. Market segment properly identified i.e., business travelers flying point-to-point. Effective pricing so far, but fees for extras keep climbing. |
| Service (ability to solicit customer feedback & respond) | Customers need to be informed of changes or inconveniences. The Customer Bill of Rights providing rewards for customers experiencing operational problems, delays or cancellations has helped. |
| **Secondary (or support):** |  |
| Procurement (win-win relationships with suppliers, reduced dependence on single supplier) | Aircraft procurement plan to support growth. Increased number of code-sharing agreements allows customers the flexibility for extended international travel. |
| Technology development (state of the art hardware & software, innovative culture & qualified personnel) | Investments in technology from the beginning of the airline. Process initiatives such as automated baggage handling, web-based ticketing, paperless cockpit etc., |
| Human resource management (effective recruitment, incentive & retention mechanisms) | Non-unionized workforce (so far), reward systems such as stock-option plans, profit sharing, innovative recruitment policies and culture promoting camaraderie…employees called ‘crewmembers’. |
| General Administration (effective planning systems to establish goals & strategies, access to capital, effective top management communication, relationships with diverse stakeholders) | Change of the CEO from David Neeleman to Dave Barger in May 2007, then to Robin Hayes in 2014 signaled shifts here. Top management with expertise in airline business, should have ability to coordinate and integrate activities across the value system, and remain highly visible to inculcate organizational culture, reputation and values. |

## *Primary Activities*

In terms of primary activities, the key to JetBlue’s ability to successfully compete in the market appeared to reside primarily in its operations. Having copied many of its operational systems from Southwest, JetBlue was able to effectively control costs. However, unlike Southwest, JetBlue had had major problems with its service component. This is an example of how one component of the value chain can detract from, rather than add, value to the overall experience.

### *Support Activities*

With regards to support activities, a competitive advantage can be achieved by developing a strong general administration that is built around visionary leadership and a supportive human resource, technological or external network of willing partners. JetBlue’s change of CEO from Neeleman to Barger, and then to Hayes appeared to be positive ones. Certainly the growth in code-share agreements with other airlines would help increase JetBlue’s appeal to its customers, therefore increase value, and the new emphasis on cost controls would please shareholders.

In addition, see the concept of the *resource-based view of the firm*, and the three key types of resources: *tangible resources, intangible resources*, and *organizational capabilities.* A firm’s strengths and capabilities – no matter how unique or impressive – do NOT necessarily lead to a competitive advantage. The resource-based view of the firm takes the perspective that firms’ competitive advantages are due to their endowment of strategic resources that are valuable, rare, costly to imitate, and costly to substitute. Without these unique resources, the firm can only attain competitive parity. RBV goes beyond a SWOT analysis to integrate internal and external perspectives in a broader competitive context. RBV can reveal how core competencies embedded in a firm can help it exploit new product and market opportunities.

An important issue to focus on here is the importance of intangible resources like innovation and reputation. Especially in mature brands, sustaining reputation is essential. Look at resources that are controlled by JetBlue that might enable it to develop and implement value-creating strategies. Based on their reading of the case, students might identify those resources to include:

*Tangible Resources:*

*Financial:* Hard to reliably assess. Cost fluctuations in fuel and fees are hard to anticipate. Certainly profit margins are not where they should be.

*Physical:* New terminal at JFK, new planes, but questions remain about financing and increased capital expenditures.

*Technological*: Doesn’t appear that these resources are any more developed than any other airline.

*Organizational:* Too early to assess Hayes’ affect on the organization.

*Intangible Resources:*

*Human:* Originally, this might have been a strength. Now union troubles, financial and service concerns might have eroded willingness of employees to step up.

*Innovation and creativity:* Neeleman’s original vision for the airline – to “bring humanity back to air travel” – was creative. Idea to provide *LiveTV* was innovative.

*Reputation:* Originally, JetBlue had a very good reputation – consistent travel awards – but after the Valentine’s Day incident the reputation became tarnished. Now extra fees for things like pillows may confuse customers. What does JetBlue stand for?

Determining whether the internal resources are valuable, rare, difficult to imitate, or difficult to substitute (*VRIN*) can help a firm sustain a competitive advantage. See Exhibit 3.6. Applying the *VRIN* concept, in case of JetBlue, it is too early to say whether its resources are *inimitable.* This is because there is not much of *path dependency* or *causal ambiguity* and *social complexity* developed at this point in time. As can be noticed, its efficient low-cost operations can lead to a sustainable competitive advantage in future. However, the low-cost operations themselves are interrelated to other activities such as technology development, better human resource management etc. The event of severe weather in February 2007 exposed many shortcomings of JetBlue’s low-cost system, particularly in the area of communication with customers as well as baggage handling. JetBlue should work to develop an interlocking system of mutually reinforcing competencies that would make it simultaneously valuable, rare, inimitable and non-substitutable, thereby providing a competitive advantage.

**Referencing Chapter 4: Recognizing a Firm’s Intellectual Assets**

See the concepts of *intellectual capital*, *human capital*, and *social capital,* all of which are intangible assets that a company such as JetBlue needs to have in order to compete successfully. *Intellectual capital* is a measure of the value of a firm’s intangible assets, its reputation, employee loyalty and commitment, customer relationships, company values, brand names, and the experience and skills of employees. How do companies create value in a knowledge intensive economy? The general answer is to attract and leverage human capital (intangible assets) effectively through mechanisms that create products and services of value over time.

*Human capital* involves the individual capabilities, knowledge, skills, and experience of the company’s employees and managers. This knowledge is relevant to the task at hand, as is the capacity to add to this reservoir of knowledge, skills, and experience through learning. Human capital is the foundation of intellectual capital. Intellectual capital is developed through attracting, developing, and retaining human capital. See Chapter 4, Exhibit 4.2.

Success in retaining human capital could also be attributed to the nurturing of the “social ties” or social capital.*Social capital* is a function of the network of relationships that individuals have throughout the organization and beyond. Relationships are critical in sharing and leveraging knowledge and in acquiring resources. Social capital can extend beyond the organizational boundaries to include relationships between the firm and its suppliers, customers, and alliance partners.

*Dynamic capabilities* involve a firm’s capacity to build and protect a competitive advantage, which rests on knowledge, assets, competencies, complementary assets, and technologies. Dynamic capabilities include the ability to sense and seize new opportunities, generate new knowledge, and reconfigure existing assets and capabilities. These capabilities are related to the entrepreneurial side of the firm and are built within a firm through its environmental and technological sensing apparatus, its choices of organizational form, and its collective ability to strategize. Dynamic capabilities are about the ability of an organization to challenge the conventional wisdom within its industry and market, learn and innovate, adapt to the changing world, and continuously adopt new ways to serve the evolving needs of the market.

Intellectual assets or intangible resources are critical to organizational success. The growing importance of knowledge, coupled with the move by labor markets to reward knowledge work, tells us that investing in a company is, in essence, buying a set of talents, capabilities, skills, and ideas – intellectual capital – not physical and financial resources. Here are some questions organizations should ask.

**Human capital**: does the organization effectively attract, develop, and retain talent? Does the organization value diversity?

**Social capital:** does the organization have positive personal and professional relationships among employees and alliance partners?

**Technology:** does the organization effectively use technology to transfer best practices across the organization, codify knowledge, and develop dynamic capabilities for competitive advantage?

*Organizational Capabilities:* Hard to say what JetBlue’s current capabilities are now.

*Specific Competencies or Skills:* Originally, JetBlue’s operations were its most valuable competency. Barger seemed interested in operational controls and extending relationships with alliance partners. Certainly technology practices, especially in the operational components, are critical. Uncertain what Hayes’ focus will be. Time will tell.

***Capacity to combine resources:*** Analysts are frustrated – JetBlue should be able to use intellectual, human, and social capital to re-engage operational competencies, and once again impress customers with performance. Again, time will tell.

1. ***Is JetBlue’s competitive advantage sustainable?***

**Referencing Chapter 6: Formulating Corporate-Level Strategy**

*Corporate strategy* focuses discussion on the questions of what businesses a corporation should compete in, and how the businesses should be managed so they can create “synergy” – creating value through entering new markets or developing new technologies, either through related or unrelated diversification.

***Diversification*** is the process of firms expanding their operations by entering new businesses. In related diversification, a firm enters a different business in which it can benefit from leveraging core competencies, sharing activities, or building market power. Some possibilities include:

* Mergers and acquisitions
* Strategic alliances
* Joint ventures
* Internal development

Whatever the choice, it should create value for all stakeholders – employees, suppliers, distributors, and the company itself. The choice of diversification strategy should create *synergy* so that all parties gain something they would not have had on their own.

Companies can achieve synergy through diversification in two ways:

Through related businesses (horizontal relationships)

* Sharing tangible resources
* Sharing intangible resources
* Leveraging core competencies

Or through unrelated businesses (hierarchical relationships)

* Value creation derives from corporate office
* Leveraging support activities

*Core competencies*reflect the collective learning in organizations—how to coordinate diverse production skills, integrate multiple streams of technologies, and market diverse products and services to create value. Core competencies must create superior customer value; the different businesses must all have similar elements in the value chain that require similar skills; and these activities or skills must be difficult for competitors to imitate.

*Sharing activities* means that value chain elements are shared across business units, so that two or more activities are done by one of the businesses. This allows for cost savings, but businesses need to make sure to keep control over quality and customer perception.

*Acquisition*is the incorporation of one firm into another through purchase. It can be a means of obtaining valuable resources that can help an organization expand its product offerings and services. Acquisition can lead to consolidation within an industry and can force other players to merge. Corporations can also enter new market segments by way of acquisitions.

JetBlue was in an interesting position. It had carved out a niche for itself, competing using a combined strategy, but was this enough for long-term growth? JetBlue at the end of the case was pursuing a “hybrid” model, with high-end perks plus a low-cost option. In order to keep its operations under control, JetBlue was also going after new code share partners, staying independent while also establishing strategic alliances with other airlines. In this way, JetBlue was trying to create value through related diversification, sharing the activities it could control across its lines of business, while coordinating diverse relationships with other carriers.

JetBlue had so far relied on a hub-and-spoke model, using New York as the hub, but as it expanded routes to provide a point-to-point service via code share arrangements, it was using a hybrid strategy, and becoming a hybrid model operationally as well. Did it have the core competencies to manage these expanded activities, and did it have the operational discipline to manage the associated costs? What should JetBlue do to sustain its competitive advantage?

**NOT IN THE CASE:** CEO Barger had said he was not interested in doing any acquisitions, and he did not see JetBlue as a target for a buy-out offer, even though the Luftanza deal had caused some speculation about this. Yet the airline had expanded into Alaska and on the West Coast of the U.S., and there were multiple code share agreements in place as of 2015. See <http://www.jetblue.com/airline-partners/> Was JetBlue diversifying or not?

Starting in 2014 JetBlue “will begin vying for big-spending business travelers” by offering “lie-flat seats and private suites on transcontinental flights on the highly competitive routes between Los Angeles and New York and San Francisco and New York… the new seats added to Airbus A321 planes will have adjustable firmness, a massage function, a 15-inch wide-screen television and a "wake-me-for-service" indicator if the flier decides to sleep. The private suites will include a closeable door for privacy. The airline plans to dedicate 11 planes to serve the two transcontinental routes, with expansions along the same routes and the addition of lie-flat seats on other routes, depending on demand.” In 2015, JetBlue was set to fly these “Mint business-class seats” between New York and the Caribbean. See <http://www.usatoday.com/story/todayinthesky/2015/03/15/report-jetblue-to-fly-mint-lie-flat-seats-to-caribbean/24811043/>

And as another example of how JetBlue was trying to add special “perks” to its service, here’s a story from August 2013: “as the airline industry continues to put the squeeze on luggage fees, US-based carrier JetBlue has launched a baggage delivery service that will allow flyers to bypass the carrousel and proceed directly home or to their resort holiday. JetBlue unveiled details this week of its new Bags VIP concierge service, which will hand deliver checked bags to customers’ final destination within a 40-mile radius of the airport. Promotional pricing starts at $25 for delivery of one bag and $40 for up to 10 bags.” Read more: <http://www.nydailynews.com/life-style/jetblue-launches-luggage-delivery-article-1.1422585#ixzz2bWi1CHxb>

Finally, the instructor can discuss a recap of the 2007 Bill of Rights incident, pointing out customers, some of whom said they appreciated this. As congress has said, all airlines should do this kind of thing (**NOTE** - Southwest has *always* had a “Customer Service Commitment” document, with considerably more detail than the JetBlue one – see <http://www.southwest.com/about_swa/customer_service_commitment/customer_service_commitment.html>.)

Based on passenger’s traditional issues, such as leg room, baggage handling, and effective communications, does JetBlue appear to have addressed the general concerns most travelers have about air travel? Do these initiatives further reinforce JetBlue’s differentiation advantage, or are these just things others can easily copy, as JetBlue seems to have copied, itself?

Further regarding JetBlue’s activity system, and the importance of all mutually reinforcing components’ affect on strategy, see the following graphic adapted from one produced for Southwest Airlines:

### **JetBlue’s activity system - modeled after Southwest’s activity system**





As in M. E. Porter. 1996. What is Strategy? ***Harvard Business Review,*** November-December, pp.60-79. *Also according to this article, the darker circles indicate the higher-order strategic themes. These are implemented through the clusters of tightly linked activities which are in the lighter circles.*

**NOTE** – this activity figure is not reproduced in the powerpoint slides. If the instructor has assigned the Porter 1996 article from which this figure is adapted, students can use the Porter article to assess JetBlue’s degree of integration among these activities.

**NOTE – ADDITIONAL READING, VIDEO INTERVIEWS WITH NEELEMAN & BARGER:**

JetBlue continues to rank highest in the J.D. Power Airline Satisfaction Survey <http://www.jdpower.com/press-releases/2015-north-america-airline-satisfaction-study>

JetBlue has embraced social media. See JetBlue’s Twitter page at <http://twitter.com/JetBlue>

The use of technology and marketing through social networking is an attempt to broaden JetBlue’s appeal. However, most airlines, including JetBlue have begun charging for all kinds of things like pillows, blankets, checked baggage, and new CEO Hayes announced a tiered pricing arrangement where customers can decide what “bundles” of features they want to pay for. This has prompted some to wonder if this is just getting more complicated for passengers: <http://skift.com/2015/01/29/jetblue-to-unveil-bag-fees-and-new-types-of-fares-in-the-second-quarter/> When asked if JetBlue might contemplate a merger in the future, Hayes said JetBlue is “still very committed to our organic growth plan.”

Regarding areas where JetBlue has stumbled with its competitive (dis)advantage, the February 2007 ice storm in the Northeast created many problems for JetBlue’s passengers trying to fly out of New York’s JFK airport. View the **video** commentary by one group of travelers below:

<https://www.youtube.com/watch?v=K6cwIy3pWMQ>

Further investigation showed that these JetBlue customers could not use JetBlue to get home to Sacramento. They had to pay to get an ATA flight to Chicago’s Midway, and then a Southwest flight to Sacramento, California. JetBlue also lost their luggage… This kind of customer experience is what led CEO David Neeleman to publicly apologize, and publish the Customer Bill of Rights, available here:

<http://www.jetblue.com/about/ourcompany/promise/index.html>

Do you think the existence of a bill of rights might have appeased these travelers?

Here is Neeleman’s **video** apology for the February fiasco:

<https://www.youtube.com/watch?v=-r_PIg7EAUw&list=PL8F3BBDA63E013068>

Do you think the learning and strategies outlined will be sufficient to prevent future problems?

*Business Week*’s first ever ranking of the 25 companies who provide the best customer service had Southwest in 13th place (the only airline on the list), and dropped JetBlue from contention altogether based on their February 2007 customer service failure. Here’s a description of how Southwest handled things when weather affected travelers:

<http://www.businessweek.com/stories/2007-03-04/customer-service-champs>

What additional lessons might JetBlue still have to learn?

In May of 2007, when Neeleman was replaced as CEO, the thought was “he’s a great entrepreneur, but perhaps one of those types who is much better at innovating than operating.” See the story in Time:

<http://www.time.com/time/business/article/0,8599,1619387,00.html>

CEO Dave Barger, in his first year on the job in October 2007, explained JetBlue’s competitive advantages:

<http://www.fool.com/investing/general/2007/10/03/an-interview-with-jetblues-david-barger.aspx?terms=jetblue&vstest=search_042607_linkdefault>

According to one analyst in 2012, “JetBlue isn’t immune to the industry’s bane: soaring fuel costs. Ten years ago jet fuel cost an average of 71¢ a gallon; JetBlue now pays an average of $3.15. Higher fuel costs represented 71 percent of its yearly increase in operating expenses,” and JetBlue is planning on adding more routes attractive to business travelers. That practice of adding flights and routes—thus incurring more operating and capital expenses—while the rest of the industry is shrinking to cope with fuel costs is what bothers Dahlman Rose analyst Helane Becker: “JetBlue started as the airline for the New York leisure traveler. They don’t have the route structure or the miles to compete with the majors for business dollars.… expanding this way in spite of soaring fuel costs is a risk.” See <http://www.bloomberg.com/bw/articles/2012-04-05/once-high-flying-jetblue-returns-to-earth>

Regarding the questions about whether JetBlue is positioned for being a buy-out target, as of 2012, Barger doesn’t see acquisitions or mergers as an option. He believes he can grow JetBlue “organically” by watching costs in fuel and operational activities: see **video** at <https://www.youtube.com/watch?v=yOM6csohc5c>

And see also “JetBlue Airways enters new phase of hybridisation with premium seats, two-way codeshares”, CAPA Centre for Aviation, June 27, 2013 at <http://centreforaviation.com/analysis/jetblue-airways-enters-new-phase-of-hybridisation-with-premium-seats-two-way-codeshares-109321> for more about the “hybrid” business model JetBlue appears to be trying to exploit – being low-cost PLUS differentiated.

What do you think new CEO Robin Hayes needs to focus on the most?

Just as an ironic note, in 2008, after leaving the JetBlue CEO job, Dave Neeleman started an airline in Brazil, Azul (“Blue”), using the Brazilian Embraer airliner, with the same business model as he used in starting JetBlue. See his story from 2010 about this founding at <https://www.youtube.com/watch?v=TH-l5ARltZg>

As of 2015, Azul was Brazil’s third biggest airline, and poised to raise additional capital for expansion by selling shares in an IPO. Perhaps Neeleman was successful in Brazil because the lack of intense competition in this market allowed this business model to create a “first-mover advantage”. As Brazil’s economic power grows, will other competitors come along to copy Azul, just as Neeleman’s original JetBlue copied Southwest?

**References**

Porter, M.E. 1996. “What is strategy?”, *Harvard Business Review, 74*(6): 61-78.