



**Publication Alert November 2008 –
'Market valuation of new route announcements'**

In the past 20 years, there has been a significant increase in new airline routes. Airlines can strengthen their competitive position and market power by opening new routes. However, additional routes also mean an increase in costs. For example, negotiation costs with airports, operating costs and costs to overcome possible entry barriers. The net effect of opening one extra route is therefore not always clear. Tsai et al. (2008) have developed a framework to evaluate the net welfare impacts of new routes. They use an event-study methodology to quantify these effects. The variation in the stock price after a new route announcement is taken as the dependent variable. The authors observe a positive impact on the stock price on the day of the announcement.

The authors use new route announcements made by 27 US-based carriers between 1993 and 2002 (230 announcements in total). In addition, they use the daily stock returns of each airline. The route and entry strategies were researched for every announcement.

In general, the authors observe a positive impact on the stock price on the day of the announcement. In the days before and after, no significant impact has been found, meaning that the positive effect is only on the day itself.

The authors research several route strategies. They find that a domestic new route has a higher positive impact on the stock price than an international new route. This is probably due to the higher fixed and variable costs of the latter. They also find that a connection to a hub gives the same increase as a non-hub connection. Theory states that a hub-connection should increase stock value stronger, since next to direct flights, transfer passengers can also be served by the new route. Multiple new routes have a larger effect on the stock price than a single route announcement, due to increase of customer choice and economies of scope.

Tsai et al. also test the effect of entry strategies. The stock price effect of the new route is larger when created by self-development than by an alliance. Theory states that the outcome is ambiguous, since there are costs (sharing costs) and revenue (extension market presence) advantages through alliances, but also several disadvantages (negotiation costs, loss of flexibility). A first entrant on a route has a higher positive impact on the share price (first-mover advantage). If an airline combines the new route with the acquisition of extra aircraft (an expansion strategy) or if an airline combines the new route with a price discount, then the stock price increases more sharply.

Source:

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Author: Dungchun Tsai, Shaochi Chang, WeiWei Chen and Chau-lan Tran

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