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Strategic Airline Alliances: The next 10 years?

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Airline alliances: overview

- ❑ Alliances goals
- ❑ Impact of airline alliances on consumers
- ❑ Types of alliance
 - Marketing agreements*
 - Codesharing*
 - Franchising*
 - Global alliances*
 - Equity alliance*
- ❑ The Future

Why airlines form alliances?

- ❑ Inability to grow naturally or by acquisition**
- ❑ Revenue enhancement**
- ❑ Cost reduction**
- ❑ Increasing consumer benefits**

Inability to grow

□ Inability of airlines to grow by acquisition

Legislation constrains airlines from increasing ownership and control of airlines in other countries

Some airlines regard alliances as a compromise forced upon the participants by outdated laws on national ownership

□ Inability of airlines to grow naturally

Home markets are limited in size

Access to foreign markets is subject to regulatory approval

Infrastructure constraints (eg access to slot constrained airports)

High marketing & other costs required to develop outside home

Revenue enhancement opportunities

- ❑ **Increase in level of traffic through access to new markets:**
Specially if the networks of partners complement each other as opposed to overlap
- ❑ **Increase in load factors through improved traffic feed**
- ❑ **Cooperation with airlines that previously were competitors**
- ❑ **Better GDS display (screen padding)**
- ❑ **Increase the attractiveness of flights through:**
Better co-ordination of schedules, and improving interline connections to on-line standard
Reciprocal lounge access, co-ordinate baggage handling
Co-ordination of FFP and corporate discount programmes to accrue benefits on wider range of flights

Cost reduction opportunities

- ❑ **Network economies**
 - Scheduling co-ordination and rationalisation
 - Operation of joint hubs
 - Higher frequencies (and larger aircraft)
 - Establish presence in low volume markets with minimum capital outlay
- ❑ **Reduction of duplication and increase in shared facilities**
 - Sales and distribution
 - Frequent flyer programmes
 - Airport services
 - Administration ?
- ❑ **Coordination of aircraft utilisation**
- ❑ **Joint purchasing: aircraft, corporate deals, fuel**

Consumer benefit opportunities

- ❑ **Greater choice of destinations from one airline (one-stop shopping)**
- ❑ **Lower fares??**
- ❑ **Improved connections at hubs**
- ❑ **Shared customer information (preferred seat, meals)**
- ❑ **Greater lounge access, especially at destination airport**
- ❑ **More routes to choose for FFP mile accrual**

Consumer disadvantages

- ❑ **Point-to-point competition, especially in/out of alliance hubs less likely**
- ❑ **Reduced choice of independent airline**
- ❑ **Higher fares than would otherwise be case**
- ❑ **Confusion on who provides the service**

Swiss/BA used to codeshare on operations of both airlines from different Heathrow terminals

Confirmed booking on one airline may not be confirmed on partner's system (also booking status may differ)

One partner provides free in-flight snacks, the other requires payment

Types of alliances

Degree of commitment of resources and complexity vary:

- ❑ ***Marketing agreements***
- ❑ ***Code sharing: route specific***
- ❑ ***Franchising***
- ❑ ***Strategic alliance with and without equity investment***

Marketing agreements

- ❑ **Cooperation on FFPs**
- ❑ **Shared lounges**
- ❑ **Advertising of common brand**
- ❑ **Corporate discounts**
- ❑ **Joint marketing initiatives**

Two-for-one offers

Discounts on combined services

Codesharing - definition

- ❑ Commercial agreement between airlines to place their two letter code on specified flights operated by the other(s)
- ❑ These flights will then appear in sales material, GDS screens, airport departure information etc under two or more carriers, making it impossible to know which is operating the flight
- ❑ All carriers sell seats on the flight, with an agreement between the partners on how the revenues (and sometimes costs) are shared
- ❑ It permits the offer and sale of air services two or more airlines, *normally considered as interline*, as if they were on one airline (or *on-line*)

Example:

British Midland's London -Glasgow Service BD002 is marketed by United Airlines as UA1903 for connecting pax from the US

Different types of codesharing

- ❑ **Feeder carriers and larger carriers:** eg United and bmi on Glasgow-London-Chicago
- ❑ **Two large carriers on one route and beyond (two-way codesharing – Lufthansa and Singapore Airlines on all trunk routes between the two countries)**
- ❑ **Block Space:** allowing one carrier to sell tickets up to a certain maximum number of seat on each flight of another carrier (eg Virgin/Continental)

Disclosure

Airlines must make customer aware which airline is operating the flight before ticket purchased. 33% of passengers were not aware of the codesharing and 25% were angry to find that out (IATA, 1997)

Franchising: definition

- ❑ One firm, *the franchisor* (usually large airline) has a business idea, track record and strong brand and allows another firm (usually small airline), *the franchisee*, to expand its business in a clearly defined way
 - eg British Airways with GB Airways, Sun-Air (Scandinavia), Comair (South Africa), British Mediterranean
 - ❑ Franchisee gains
 - Global brand identity, global marketing, advertising, promotion, distribution, selling, Improved financial performance
 - ❑ Franchisor obligations
 - Specify product, sales, IT and operations support, accounting and management, FFP participation, branded goods (eg uniforms, interiors)
 - ❑ Franchisee obligations
 - To supply service/brand as defined by franchisor in accordance with customer expectations for a fee
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Franchisee benefits

- ❑ Adoption of strong and established brand benefiting from the franchisor's *halo* effect
- ❑ Benefiting from the know-how of the franchisor in areas such as marketing, distribution, yield management etc, and avoiding the initial investments in such systems
- ❑ Benefiting from the franchisor's purchasing power
- ❑ Participation in franchisor's frequent flyer programme
- ❑ Providing their passengers with what looks like an on-line rather than an interline feed
- ❑ Increase in revenue and traffic

Franchisor benefits

- ❑ **Generates additional revenue from the brand**
- ❑ **Operates on thinner routes that it would be too costly to operate itself**
- ❑ **Generates additional business for its own handling, IT, accounting services (fees and lower unit costs)**
- ❑ **Increases own network scope**
- ❑ **Generates more feeder traffic**
- ❑ **Could eliminate competition (franchisee might have otherwise fed traffic to competitors)**

Strategic or global alliance

- ❑ **Two or more airlines that agree to cooperate in a number of fields:**
 - Scheduling*
 - Marketing*
 - Purchasing*
 - Administration*
 - Maintenance*
- ❑ **Member airline networks should be complementary, without much overlap**
- ❑ **This type of alliance represents the future of the airline industry at least in short term**
- ❑ **Currently only three: Star, oneworld and SkyTeam**

Equity investment or swaps

- ❑ Airline may invest in alliance partner to improve trust/commitment
- ❑ This may give a bit more control [board member(s)]
- ❑ Can be reversed (eg BA in Qantas and US Air)

- ❑ Equity exchange: *KLM/Northwest, Delta/Swissair*
- ❑ Equity investment
 - Part of privatisation trade sale: BA/Qantas, BA/AA/Iberia*
 - Rescue operation: KLM/Northwest, BA/US Air*
 - Other reasons: Lufthansa/bmi*

Strategic alliance history

- ❑ **Northwest and KLM form first strategic alliance in 1990 (Wings); later joined by Delta and others to form SkyTeam**
- ❑ **Wings given anti-trust immunity in 1993**
- ❑ **Star Alliance formed in 1997 with Lufthansa and United as founder members**
- ❑ **Oneworld formed in September 1998**
- ❑ **Qualiflyer was the fourth alliance with nine member airlines but disbanded in 2001 with the bankruptcy of Swissair, its founder**
- ❑ **Qualiflyer joined delta Airlines in Atlantic Excellence alliance; Delta moved to SkyTeam**

Strategic alliance groups (2007)



	Europe/Africa/Mid-East	North America	Central/South America	Asia
oneworld	BA, Finnair Iberia, Malev Royal Jordanian	American	Lan-Chile	Cathay Pacific Qantas Japan Airlines
SkyTeam	Air France-KLM Alitalia, CSA	Delta, Northwest Continental	Aeromexico	Korean Air
Star	Lufthansa, bmi Austrian, LOT TAP, SAS Spanair, Swiss SAA	Air Canada United Airlines US Airways		Air New Zealand Asiana Singapore Thai Airways All Nippon

Strategic alliances in 2006

	oneworld	SkyTeam	Star
Countries	150	162	162
Destinations	700	841	965
Daily departures	9,500	16,409	18,000
Fleet	2,500	2,513	3,294

Alliance group size (2006)

	Pax-km (bn)	Passengers (m)	Revenues (US\$m)
oneworld	695	290	89,649
SkyTeam	766	352	93,065
Star Alliance	819	386	122,786
Total	2,280	1,028	305,500

Alliance world revenue shares: % (2006)

	Without associates	With associates
oneworld	18.4	19.6
SkyTeam	19.1	21.8
Star Alliance	25.2	28.0

Unaligned: 10% of total revenues of existing alliance partners

Largest unaligned airlines (2006):

	Revenues (US\$m)
Emirates	8,477
Malaysia Airlines	3,602
Virgin Atlantic	4,131
Saudi Arabian	3,914
Alaska Airlines	3,334
TAM	3,381
EVA Air	2,890
Qatar Airways	2,000
Total	31,729

**Alliance revenues:
US\$305 billion
(2006)**

Regulatory restrictions on alliances

- ❑ ***Anti-trust immunity is designed to protect consumers by prohibiting competitors from colluding and engaging in anti-competitive practices such as jointly setting airfares***
- ❑ **Immunity required by both US and EU competition authorities**
- ❑ **British Airways/American alliance not yet approved by authorities, but can engage in limited codesharing**
European Commission required BA to give up 267 slots at Heathrow
US authorities required greater access to LHR by US carriers: six majors asked for 532 weekly slots to allow them to compete adequately with BA/AA

Global alliances challenges (1)

- ❑ **Increasing the degree of commitment/trust amongst members**

Transient nature of partnerships

In crises, members tend to focus on their own survival than cooperation (see below)

- ❑ **Sorting out the branding issues: alliance versus individual brand**
- ❑ **Improving service standardisation**
- ❑ **Developing alliance FFPs**
- ❑ **Establishing common IT platform**
- ❑ **Minimising organisation/culture conflicts**
- ❑ **Matching power of unions (themselves in partnership)**

Global alliances challenges (2)

- ❑ **Sorting out financial issues**
- ❑ **Stronger carriers support weaker alliance partners?**
 - Allocation of costs/revenues (pro-rates)*
 - Support for loss-making or failing partners (Lufthansa and bmi/United?)*
- ❑ **Alliances add marketing expenses**
- ❑ **Alliances can take a lot of management time**
- ❑ **There is no clear evidence of success in alliance driven cost cutting**
- ❑ **Due to competition from LCCs airlines need to simplify their business, but alliances add complexity**
- ❑ **Revenue benefits are a zero sum game**
- ❑ **Post 9/11, carriers place renewed focus on tactical vs strategic alliances**
- ❑ **Post 9/11, alliances supportive in retaining network presence in face of network cuts**

The future

- ❑ **Alliances could be replaced by Air France-KLM type mergers which would include US airlines if US/EU authorities agree to lift ownership restrictions**
- ❑ **No sign of rush by uncommitted to join strategic alliance; last major one to join an alliance was Japan Airlines**
- ❑ **New strategic alliance group unlikely, but probably some movement between big three**
- ❑ **Most recent activity in Asia, especially China**
- ❑ **Some progress needed on joint alliance cost reduction initiatives likely: otherwise membership benefit might be increasingly questioned**
- ❑ **Franchises do not seem to be stable longer term solution**