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| STRATEGIC ALLIANCE IN GLOBAL AIRLINE INDUSTRY  **CASE STUDY ANALYSIS** |

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# Introduction:

Air transport is a major industry in the world economy on its own, with air travel revenues usually accounting for about 1 percent of national GDP. Air transport has a widely acknowledged impact on the development of world trade and tourism; and, from a wider perspective, the fast and safe air transport of people and goods to any place in the world facilitates economic, political, and social change. The main operators of passenger air transport, the commercial airlines, comprise a challenging industry characterized both in the US and the rest of the world by low profits and high volatility in returns. A distinctive element in the airline business is that most of the largest carriers in the world are enrolled in one of the three existing international strategic alliances—one world, Star Alliance, and Sky Team—which are often recalled as the global airline alliances. These networks of airlines provide their members with a rich international route portfolio at a marginal cost that would be difficult to be reached through organic growth. As air transport services have been liberalized new competitors have entered the market. In most cases, the incoming carriers have adopted the low-cost, low-frills business model, contrasting with the full-service of incumbent traditional carriers.

# The strategic and environmental factors which are mainly responsible for the formation of global airline network:

Today there are three Global Airline Alliances (GALs) in the world: Star Alliance, Sky Team and One World. Formed during the period 1997-2000, more than a decade later half of the seating capacity in the world and around 80% of the intercontinental traffic between Asia, Europe, and America are served by airlines enrolled in the Global Airline Alliances.33 Since their creation, the number of GAL members has been increasing from year to year. The number of destinations covered by the three alliances has followed a similar pattern. The birth of airline alliances is historically linked to the development of the hub-and-spoke scheme and the need of airlines to build domestic and international networks. After the US Airline Deregulation Act of 1978, US airlines shifted their network structures from a point-to-point scheme to a hub-and-spoke scheme as a way to increase their efficiency through hub economies. Large US carriers established code shares with more cost-effective regional carriers to feed their larger and more profitable medium-haul and long-haul networks, initiating the regional alliances. At a different scale, independent US international carriers without strong domestic networks, like Pan American and Trans World Airlines (TWA),found themselves at a competitive disadvantage against other competing carriers with both domestic and international businesses, as they did not have a domestic network to feed their international routes. In fact, both carriers ended up disappearing in 1991 and 2001, respectively.

International alliances began less a few years later after deregulation, as US airlines realized of the benefits of expanding the national hub-and-spoke network structures to a multi-hub international network in which foreign carriers and large US carriers could feed each other’s traffic through code sharing connections. Airlines were aware that controlling and operating a hub in a foreign country was politically infeasible, because of regulatory limitations to sabotage and foreign ownership of airlines. It is through international alliances, foreign airlines with strong domestic networks could feed international routes of their alliance partners, and vice versa, exploiting economies of hub density in a multi-hub network.

According to Iatrou & Oretti (2007), the first international alliance was formed in 1986, when Air Florida began feeding British Island with passengers from its US network for the code shared British Island’s London-Amsterdam route. Fernandez de la Torre (1999) mentions American Airlines and Qantas point-specific alliance in 1985 as the first international code share agreement.

During following decades, large carriers found themselves in scenarios with high incentives to develop intercontinental partnerships. In the US, pressure from low-cost carriers (LCCs) forced US legacy carriers to focus more on transatlantic services due to their higher profitability. In the international scale, competition with smaller-scale, less efficient European carriers put US carriers in a better competitive position against its EU competitors; despite that, the impossibility for foreign-based airlines to establish hub-and-spoke networks in the EU by themselves forced US carriers to partner with European carriers through strategic alliances. In Europe, the smaller domestic markets had made foreign services crucial for major carriers, and some European airlines had already more than 30% of their profits from transatlantic services (Egan, 2001). The creation of the European Union single market, combined with the persistence of barriers to entry, and the existence of very few US carriers to form an alliance with, also drove European carriers to consolidate through international alliances and mergers.

Many of the first bilateral and multilateral alliances were in the transatlantic market. KLM and

Northwest Airlines formed in 1988 the oldest strategic alliance, and the most important bilateral alliance of the 1980s. Swissair and Delta Airlines partnered in 1989. In the early 1990s, other bilateral strategic alliances in the North Atlantic were British Airways-US Airways, and United-Lufthansa. From that time, until the consolidation of the three Global Airline Alliances (GALs), there were other attempts of multilateral airline alliances.

Two main characteristics can be pointed out from these alliance projects. First, with the exception of the three Global Airline Alliances and Wings (KLM-Northwest Airlines’ alliance), all other multi-airline alliances were led by Swissair. Second, the majority of the partnering carriers were small-and medium- sized European airlines, which were seeking for either a transatlantic link with a US-based carrier, a strong European alliance, or both. They were pursuing a competitive edge against the “Big Three” European carriers (Air France, British Airways, and Lufthansa), in a recently liberalized European market (Knorr & Arndt, 2003).

Failing alliances were characterized by the lack of common, long term goals between partners (Iatrou&Oretti, 2007), which is crucial for the success of strategic alliances. Knorr and Arndt(2003) also highlighted Swiss’ management hubris as major cause for failure in the European alliances. Although Switzerland was excluded from the EU aviation market and Swissair’s Zurichhub had a limited growth potential, Swissair demanded the role of the alliances’ undisputed leader.

Often, a cause of divergence was in the choice of the US partner. An example is the Alcazar Project, for which Swissair refused to accept KLM’s proposed US partner (Northwest) in detriment of itsmore preferred option (Delta Airlines) (Iatrou&Oretti, 2007). Another difference between an

alliance like Qualiflyer and the current GALs is that in Qualiflyer all the members gravitated around Swissair, and, with very few exceptions, all bilateral agreements in the alliance involved Swissair(Suen, 2002). As a matter of fact, the absence of a large airline backing Swissair’s multi-airline alliances could have been behind these failures, as Swissair’s partners preferred to join the Big Three European carriers in the Global Airline Alliances that were been launched. These latter options provided small- and medium-size European airlines with a more extensive international network, while continuing in the Alcazar Project or European Quality Alliance required looking for intercontinental partners –mainly with US carriers. At some point, all Swissair’s alliances disintegrated due to defections of its alliance partners to competing groupings. In fact, between1996 and 2000, Singapore Airlines, SAS, and the Austrian Airline Group (Austrian Airlines, LaudaAir, and Tyrolean Airlines) opted for the Star Alliance; Finnair joined oneworld; and Delta joinedefforts with Air France to build their own alliance, SkyTeam.

Star Alliance was launched by United Airlines, Air Canada, Lufthansa, SAS, and ThaiAirways International in May 1997. Before the end of the year, the Brazilian carrier Varig Airlines (defunct in 2007) joined Star Alliance. With the entrance of Air New Zealand and Ansett Australia in March 1999, the alliance had members in all continents except for Africa.

One worldis a global airline network formed in September 1998 by five airlines from four continents: American Airlines, Canadian Airlines (defunct in 2001), British Airways, Cathay Pacific and Qantas. Oneworld became operative in February 1999. The first member from South America was LAN in May 1999. As well as Star Alliance and SkyTeam, most of the members had subsidiary airlines that soon became member affiliates, like Iberia Regional Air Nostrum in September 1999, and LAN Express and LAN Peru in May 1999.

SkyTeam was the last of the multi-airline alliances to be formed. It was founded by DeltaAir Lines, Aeroméxico, Air France, and Korean Air in June 2000. In 2002, Sky Team members Delta, Air France, Korean Air, Alitalia, and Czech Airlines obtained a common grant of antitrust immunity within the alliance. When Continental Airlines, KLM, and Northwest Airlines, joined SkyTeam in 2004, Sky Team surpassed One world as the second largest alliance in the world, behind Star Alliance.

Although, the period 1988-2000 was the stage of formation of strategic alliances, of which only the three global airline alliances continue today, the agreements between airlines would continue to take place during the next decade.

# The strategic benefits or otherwise of membership of these alliances to individual airlines

The air transport industry is highly regulated compared to other industries. In fact, the birth and growth of global alliances is closely tied to the regulatory frameworks and competitive issues in the countries where allied carriers are based. National governments have mostly prevented airlines from deeper forms of collaboration than global airline alliances by limiting the ownership and control of national carriers by foreigners and, sometimes, by restricting the international air transport. Although the regulatory environment is in constant evolution, the understanding of the current drivers in the competitive assessment of airline alliances helps to explain the trends in global airline alliances and to predict its evolution. This chapter reviews the effects of collaborative schemes between airlines on consumers and competing unaligned airlines, as well as the current regulatory framework in the air transport industry from the perspective of global airline alliances.

As a case of the greatest interest, our focus of study here will be in the United States and the

European Union, which by large hold the most advanced international collaboration between countries. In addition, their markets are very representative of the airline industry, as together they account for a 60% of the world traffic in RPK terms. Also, the transatlantic market, i.e. the Europe-

North America flow, represents a 9% of the total traffic in the world, being the most intensive intercontinental commercial flow in the world, and the third total largest, after the EU-intra and US domestic markets.48 The transatlantic routes are also where global alliances initiated, and, as well, they have been the main focus of attention of researchers in the analysis of the effects of allianceson consumers’ welfare.

The formation of international airline alliances implies the expansion of the hub-and-spoke networks, frequent flier programs and computerized reservation systems to a competitive scenario of collaboration between airlines. From a customer perspective, alliances have a positive impact on connecting passengers by coordinating flight schedules within an alliance, improving the convenience of connections at airports decreasing connecting times between gates and lowering transfer times for checked luggage, and unifying frequent flyer programs.

Similarly, airlines can reduce their unit costs exploiting economies of traffic density, scale, and scope. These cost reductions can either be transmitted to final consumers on a given route or, alternatively, airlines could benefit from cooperative pricing on (part of) the routes of their shared network. The collaboration in price-setting is only allowed when regulators concede antitrust immunity (ATI) to airlines in the provision of their join transport services, although airlines may also find subtle ways to coordinate fares.

The classic economic theories distinguish between two types of alliances when a pair of airlines that market prior to the alliance, and complementary alliances, when the two airlines are combining their network to jointly provide a service for connecting passengers.

In parallel alliances two allied carriers continue to provide service on a route before and after the alliance. This phenomenon is seen in the flow between hub-to-hub airports, where airlines were already overlapping prior to the alliance. As airlines cooperate in the hub-to-hub market, they reduce the number of competitors on the non-stop service. According to the first studies of Park and Brueckner and a classic industrial organization perspective, higher fares are expected from a collusive behavior of airlines, as they maximize their combined profits. Oum et al. (2000) argued that the degree of overlap between the respective networks is usually a key determinant because the higher the overlap, the more severe are the competition concerns and the more likely are price increases as a consequence of cooperation.

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# Critical Evaluation of the Forms of Management used in major airline alliances for ensuring corporate objective:

Strategic alliances are basically formed by the airlines so that the airline could achieve broader operation in terms of geographic spread. This enables the airlines organization’s to generate extra revenue without investing money for increasing of fleet and other necessary infrastructure. A therefore strategic alliance acts as a catalyst to the organization for achieving better performance level and hence profitability.

These typical alliances are thus made so that customers of the company can be given maximum satisfaction by providing large coverage of destinations and at the same time help in achieving optimum performance. Thus , these modern strategic alliance in the airline industry across the globe is essentially a tool for the companies as a means of competitive advantage for the airline companies.

The strategic alliance such as Star Alliance acts as a separate entity for proper functioning of the alliance. The functioning of the alliance is coordinated by a specialized team formed by the member of the organization known as “Alliance management Team”. The specialized team looks the daily operation and functioning of the alliance. It is essential to mention that these alliances which are formed for strategic collaboration among the airlines company are independent in its nature. The management of the strategic alliance team overlooks the entire operations and other activities such as contribution of revenue in comparison to the benefit achieved by the members, performance of each of the members.

The management of these alliances also acts as a communication centers for the members for daily operations, flight schedules and other important activities necessary for managing the coordinated network.

Therefore it can be analyzed that the running and operation of these strategic alliances are neutral in its approach. The management of the these organizations takes a rigid control so that no member can be benefitted extra in proportion to the contribution made by the member organizations. Moreover it is essential to the mention that senior management of these strategic alliances is formed by the senior management officials of the member organization. Thus it can be inferred that the particular body of the strategic alliance is handles by professional who has wide expertise in airlines operation industry. The board member of the body also follows and ensures that the professional standard and the rules, regulations and terms and conditions of the agreement of the network alliance are followed stringently. It also ensures that no conflict of interest happen in the alliance and members can be subject to strict punishment if the terms and conditions of the strategic alliance are violated for the purpose of benefits.

The management structure of the alliances are made in such a way that the all the operational activity can be performed smoothly. Moreover it also ensures that there is a proper communication between the departments so that the corporate can be fulfilled. The management ensures that the real time information can be given to the members so that the companies can get the best benefit of the alliance.

Thu it can be inferred that the management of the organization is highly professional and follow a consultative style of functioning so that the objective of the alliance can be fulfilled. Moreover strategic decisions within the co operational framework such as efforts of continuous improvement of information system so that the real time data pertaining to the schedule and the other necessary information can be delivered to the members on real time basis.

Therefore it can be inferred from the structure, form and operation of the management of the strategic alliance body that they function in a highly professional manner to monitor the performance and give the necessary information to the members for effective operation. Thus these networks thus aim at working for fulfillment of the formation of the network.

# Conclusion:

Star Alliance shows an upward trend despite its significant size increase, which couldhave driven the alliance members to have code share agreements with a fewer percentage of totalmembers. Then, this growth may be an implicit proof of a solid integration of incoming members.SkyTeam shows ups and downs during the period of analysis but, although by 2011 an averageSkyTeam member has code sharing relationships with two thirds of its partners, there has been noimprovement in this indicator during the period 2006-2011 despite maintaining a constant numberof GAL members. The code share partnerships between GAL partners, differentiating them from the rest of code share agreements, are justified by some indicators associating partnerships betweenairline of the same GAL with a more intense and more durable partnership. In a comparison of the three GALs, SkyTeam and o eworld show a much smaller difference than Star Alliance, whose intra-alliance partnerships are still of a “comprehensive” reach for 46% of the total of intra-alliance partnerships. Thedifferences between members of the same GAL, however, are significant; for example, the size oftwo partner airlines, when compared by annual revenues, may differ by a factor of over 100.Although this limits the implications of our analysis to generalize from one GAL to all its members,the distribution of airlines by size is fairly similar among the three GALs, validating the comparison between alliances.