

## A Perspective on Global Airline Alliances

a report by

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### Introduction

Alliances in the airline industry allow carriers to enter markets indirectly where cost and regulatory barriers would foreclose direct entry. They are a means to link multiple markets together, such as North America, Europe and Asia. An alliance tries to capture the best players in each market and consolidate their positions. Almost all alliances integrate partners from all these markets.

In the US, airline partnerships were formed before deregulation in 1978, when Pan Am entered into an agreement with Air Afrique through a blocked space concept. The trend of forming alliances grew faster after airline deregulation. American Airlines and British Airways started code-sharing transatlantic flights in 1987; Air Canada, Lufthansa, SAS, Thai Airways International and United Airlines launched the Star Alliance in 1999, and Air France, Delta Air Lines, Aeromexico and Korean Air Lines launched the SkyTeam Alliance in 2000, which expanded to include Czech Airlines and Alitalia.

### The Impact of Alliances on Passengers

Benefits to passengers resulting from an alliance include code-sharing, common frequent-flier programmes and online destinations. Code-sharing is the process of placing one's airline code on another airline's flight. For a code-sharing flight, each partner sets its own fare for the entire trip, covering both the segment it flies and the one its partner flies. Code-sharing allows an airline to sell seats on its partner's plane as if they were its own, enabling the airline to expand its route network without adding any aeroplanes. For customers, code-sharing enables passengers to check in at an airport and obtain their boarding passes not only for their initial outbound flight, but also for the entire trip. Code-sharing programmes also have the advantage of simplifying ticket purchase. A passenger does not need to buy two tickets from two different airlines if they want to travel from one destination to another.

Code-sharing programmes have become more effective with the development of hub networks. A

hub-and-spoke system allows fewer aeroplanes to cover a greater number of destinations. By concentrating traffic on routes through the hub, air carriers – under code-sharing agreements – can offer customers with online services. Airlines can therefore advertise to a much larger market area and expand their market size at a relatively low cost. In order to realise this marketing goal and offer online services, airlines – under code-sharing agreements – need to harmonise their schedules, ticketing and baggage handling services.

Frequent-flier programmes allow passengers flying frequently on a particular carrier to earn free tickets after accumulating a certain number of miles. First offered in 1981 by American Airlines, the frequent-flier programme has been a tremendous success and has quickly become a standard in the airline industry as other carriers started to develop similar programmes. The main objective of offering frequent-flier programmes is to increase loyalty of passengers to that particular airline. Alliance frequent-flier programmes allow members to earn and redeem miles on any carrier in the alliance. Airlines believe that, through alliances, reciprocal frequent-flier benefits increase the value of each partner's programme. Passengers are allowed to pool their frequent-flier points and choose from more destinations that are flown by all airlines in the alliance. Alliances also help to decrease the number of 'blackout dates' (periods when frequent-flier rewards cannot be redeemed) because, under alliance agreements, frequency of flights and available seats usually increase.

Alliances offer passengers online services and destinations that are directly associated with code-sharing agreements. While airlines not belonging to the same alliances can form 'interline' agreements, online agreements within an alliance provide passengers with reciprocal frequent-flier programmes, airport lounge rights and privileges such as airlines holding outgoing flights to wait for delayed incoming flights. In addition, online fares are usually less expensive than under interline agreements. Under code-share agreements, airlines can offer online air fares that are competitive.

Airlines can also offer an increasing number of online destinations to passengers. By combining the networks of each airline in an alliance, passengers can fly from one city (country) to another through a multi-hub, multi-airline (usually two) system.

Table 1 shows the number of destinations served by each airline in the OneWorld Alliance. None of the airlines in the alliance offers more than half of what the alliance as a whole can offer.

### The Impact of Alliances on Airline Operations

In addition to the benefits realised by passengers from an alliance, airlines in the same alliance also benefit as they share tangible and intangible resources, decrease cost and increase differentiation.

Tangible resources mean financial and physical assets. An alliance aims to leverage each partner's capabilities to increase efficiency. Existing resources are leveraged more efficiently by the airline's capability to create a larger volume of business for the alliance. SkyTeam Cargo, for instance, allows Air France and Korean Air Lines to increase freight volumes between Asia and Europe and to fill Delta and Aeromexico aeroplane holds. Delta does not possess aeroplanes with specific cargo purposes. The expertise of Air France and Korean Air Lines in that field can increase SkyTeam Cargo business for future growth just by optimising already existing physical assets. Another benefit of forming an alliance is the ability to increase negotiating and bargaining power with aircraft manufacturers and fuel and services suppliers.

Intangible resources include technology, reputation and corporate culture. Airlines in the same alliance need to communicate information and so share a common information system in order for passengers to benefit from code-sharing, scheduling, frequent-flier programmes and ticket reservation. Compatibility between technology systems is a key success factor when competing in the alliance business. Corporate culture represents another intangible resource that airlines within a given alliance are faced with and must try to leverage. Airlines in global alliances are faced with the challenge of assimilating Asian, European, African and American corporate culture. Star Alliance, for example, has set up a Star Alliance Board to facilitate alliance management decisions.

### Legal Issues in Airline Alliances

The Department of Transportation (DOT) and the Department of Justice (DOJ) in the US both have a

**Table 1: Number of Destinations Served by Each Airline in the OneWorld Alliance**

Airline	Destinations
Aer Lingus	31
British Airways	230
Cathay Pacific	44
Finnair	61
Iberia	97
American Airlines	239
Lan Chile	44
Qantas Airways	89
<b>OneWorld Destinations</b>	<b>565</b>

Source: <http://www.OneWorld.com>

key role in ensuring the most efficient market possible, and to prohibit unfair competitive practices that alliance agreements might institute. In 1998, the DOT issued its Domestic Competition Guidelines to protect new entrants in domestic US air transport markets.

The DOT would prohibit airlines from merging or acquiring the assets of another airline if the resulting carrier would substantially lessen competition. The DOT would not approve a new alliance that would result in unreasonable industry concentration or excessive market domination, unless the merging airlines were willing to surrender gates, facilities and other airport access to smaller carriers. The DOJ has authority under the Clayton Act to institute judicial proceedings if it determines that a merger would create a monopoly or lessen competition.

When the proposal of an alliance between American Airlines and British Airways was introduced, a requirement was that 250 weekly slots – out of which 180 were at Heathrow Airport – be relinquished. Likewise, proposals for mergers between American Airlines and TWA, and between United Airlines and US Airways, were also considered by the DOT and DOJ for their impact on market competition and dominance.

Another legal issue is antitrust immunity to alliances. Antitrust immunity is a key factor that contributes significantly to the success of an alliance. The US DOT grants antitrust immunity to international alliances if there is an 'open skies' agreement between the US and the foreign airline's country. In January 1993, the DOT granted antitrust immunity to the Northwest/KLM alliance in conjunction with the US–Netherlands open skies accord. In April 1995, the DOT issued its US International Aviation Policy Statement to express its desire for open skies agreements and to endorse the growing trend towards alliances between US and foreign airlines. ■