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IN THE AIRLINE INDUSTRY

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STRATEGIC ALLIANCES IN THE AIRLINE INDUSTRY

GLOBALIZATION

Most American travelers are really excited by their ability to hop a domestic airline flight, make a connection with an international foreign air carrier and arrive at some distant destination and have all the mileage count toward their frequent flier program mileage. While relaxing in some distant vacation spot, the traveler can earn additional frequent flier mileage by seeking hotel accommodations at any one of several establishments with which, for example, Northwest has an agreement - - - Radisson, Marriott, Hyatt, Western and Holiday Inn. If an automobile is necessary, still more frequent flier mileage can be earned from Northwest by restricting your selection to autos rented by Budget, National or Hertz rental agencies.

On the other hand, a shipper of goods would probably become excited about tendering a shipment to United Airlines and be assured that it would make a connecting flight with British Airways which, in turn, would interline the shipment with Australian Airlines to its final destination.

Strategic air alliances can mean a lot for passengers and shippers. Strategic marketing alliances for airline passengers have been in the process of forming for the last several years. The air alliances are relatively new for shippers. The latest buzzwords to be found in the air industry are such terms as marketing agreements, market-specific agreements, route-specific agreements, management

STRATEGIC ALLIANCES IN THE AIRLINE INDUSTRY

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A shipper of goods could become excited about tendering a shipment to United Airlines and be assured that it would make a connecting flight with British Airways which, in turn, would interline the shipment with Australian Airlines to its final destination.

While the strategic marketing alliances for airline passengers have been in the process of forming for the last several years, the air alliances are relatively new for shippers. The latest buzzwords to be found in the air industry include such terms as marketing agreements, market-specific agreements, route-specific agreements, management agreements and, of course, equity alliances or equity swaps. Equity swaps? Most consumers probably do not know that Northwest Airlines and KLM Royal Dutch Airlines each own 14.9% of the other. Nor do they know that Delta and Swissair own 5% of each other; or that Continental Airlines and Air Micronesia own 30% of each other. To understand this latest phenomenon of marketing alliances, equity alliances and frequent flier alliances, we need to examine a term called **"globalization."**

Globalization of the U. S. Airline industry began in 1977 and 1978 with the deregulation of the cargo and passenger segments respectively. Eventually, Canada, the United Kingdom, Japan, Australia, and other countries experimented with deregulation, liberalization and even privatization of their airline industries. It should be remembered that deregulation of the airline industry, domestically and internationally, has erupted upon the scene as a result of forces outside of the control of the airline industry. Globalization is the airship flying toward tomorrow; (domestic and international) deregulation is the current state-of-the-art fuel being used to power the ship; North America and Europe probably were the first two passengers on that ship to buy - but not pay for - their tickets. Many other passengers (i.e., countries/airline companies) are scrambling for tickets by jockeying for a position in the line that is forming.

The European Common Market added fuel to the fire of regulatory liberalization with the Treaty of Rome test of airline competition and pricing in the 1986 Nouvelles Frontieres case which held that the rules of competition which exist under the Treaty of Rome do, indeed, apply to aviation. At that point, the FUTURE was developing around an attempt to foster overall economic airline integration in Europe which would set up a chain reaction around the world.[1]

As a result, North America and Europe, two of the three major developed regions of the world, are moving rapidly to structurally change air transportation into an arena of open competition by initiating strategic alternatives available to them in the deregulated world of the airline industry. Airline companies in the rest of the world, including the less developed regions, are **SEARCHING FOR AND SIGNING UP PARTNERS WITH WHOM TO DANCE TO THE NEW TUNE THE WORLD IS NOW PLAYING.** As a result of domestic and international deregulation, mergers, consolidations, and bankruptcies, these relationships between the airline companies are developing into an important **THREE-STEP** set of **Strategic Marketing Alternatives Identified** as: **(1) MARKETING ALLIANCES, (2) EQUITY ALLIANCES,** and the **(3) FREQUENT FLIER ALLIANCES** - - - a hybrid or specialized variation of the marketing alliance.

STRATEGIC ALLIANCES

Of the many types of alliances available to enterprising airline companies, the three most important are **MARKETING, EQUITY** and **FREQUENT FLIER PROGRAMS.** The last few years has seen a dramatic increase in all three types. Out of one-hundred, seventy-two alliances identified by Mead Jennings in the August, 1990 issue of **AIRLINE BUSINESS,** eighty-two of the agreements (47.67%) involved equity investments. More specifically, fifty-six per cent of these 82 agreements were made in the last five years (see **TABLE 3, APPENDIX**). An example is the first truly "global" alliance between Delta, Singapore and Swissair which includes the coordination of international fares and flight schedules, the loaning of flight attendants and the possibility of joint buying opportunities.[2]

MARKETING ALLIANCES

In the category of **MARKETING ALLIANCES**, we find the British Airways and United agreement to coordinate schedules and to share codes of international flights; but no equity swaps. Carried to an extreme, one would find a route-specific agreement which refers to an agreement between two airlines regarding the contribution of each airline to a cooperative effort over a specific route (e.g. New York to Sidney, Australia).

The **EQUITY SWAP** - - another name for alliance partners buying into each other - - is a relatively new variation on the much older marketing alliance theme. It is interesting to note that American Airlines serves as a partner to seven other major airlines; Aer Lingus, Air New Zealand, Cathay Pacific, Finnair, Malev, Qantas, and Singapore Airlines. American has picked up an equity position (7.5%) in only one of these airlines; Air New Zealand. Conversely, these same seven airlines serve as partners for American with Air New Zealand holding a 7.5% equity position in American Airlines. Among these seven partners, American has only one wide-ranging marketing alliance with Qantas. The other six alliances are route-or market-specific agreements.

TABLE 1 provides some insight into the relationships that have been established among the airline companies of the world and U.S. airline companies. The last column indicates what kind of relationship exists between any two carriers; "M" means there is a wide-ranging marketing alliance agreement between the two carriers; "R" means the agreement covers only a specific route or specific market; "J" means there is a joint venture between the two firms; "C" means the agreement is for cargo only and "MAN" means there is a management contract in existence.[3]

Among American Airlines' seven partners, it has only one equity position (Air New Zealand), one wide-ranging marketing alliance (Qantas) and five route-or market-specific alliances (Aer Lingus, Cathay, Finnair, Malev and Singapore).

Continental holds an equity position in both of its partners and, in addition to the 9.9% position it holds in SAS, it also has a wide-ranging marketing alliance in force with SAS Airlines.

In addition to Delta's equity alliance with two of its three partners, it also holds a wide-ranging marketing alliance with the same two partners. Delta does have a route-or market-specific alliance with British Airways, its third partner, but no equity.

Northwest Airlines and KLM Royal Dutch Airlines each hold a 14.9% equity interest in each other but no specific marketing alliance.

Pan Am's two partners share no equity alliances with their domestic U.S. carrier. However, Aeroflot holds a wide-ranging marketing alliance, while Malev has a route-or market-specific alliance with Pan Am.

Trans World Airlines' partner, USAir, has agreed to a wide-ranging marketing alliance with TWA but no equity swap.

United has a route-or market-specific alliance with both Alitalia and Australian Airlines and a wide-ranging marketing alliance with British Airways but no equity alliances with any of them.

USAir is in a similar position with its two partners in that it holds no equity positions in either but does have a wide-ranging marketing alliance with both Alitalia and TWA Airlines.

EQUITY ALLIANCES

It is sometimes difficult to separate the new variation - - - equity partnerships - - - from the old marketing alliance theme. The practice of alliance partners buying into each other has quickly gained acceptance in the airline industry even though the strategy is expensive, time consuming and is not much more than a fad/trend.

While American Airlines has the largest number of partners, at seven, it holds equity in only one of these carriers; a reciprocal 7.5% equity alliance with Air New Zealand **(TABLE 1)**.

The largest equity holdings are the reciprocal amounts of Continental Airlines and Air Micronesia at 30% each. Continental also holds a 9.9% reciprocal equity position with SAS Airlines.

Delta holds a 5% equity position in Swissair. In most cases, the equity positions of each carrier is a reciprocal amount of a carrier's partner. Uncharacteristically, Swissair holds a 4.6% equity position in Delta. In a similar uncharacteristic relationship, Delta holds a 5% equity in Singapore but Singapore holds only 2.8% equity in Delta.

Northwest and KLM Royal Dutch Airlines each hold a 14.9% equity interest in each other.

Pan American has two partners, Aeroflot and Malev Airlines but holds no equity position in either of them, nor do they hold an equity position in Pan Am.

Trans World Airlines (TWA) has only one partner, USAir. Neither airline holds an equity position in the other carrier.

United Airlines has three partners, Alitalia, Australian, and

TABLE 1

STRATEGIC ALLIANCES

OF AMERICAN CARRIERS IN THE AIRLINE INDUSTRY

CARRIER	PARTNER	CARRIER'S EQUITY IN PARTNER(%)	PARTNER'S EQUITY IN CARRIER(%)	PACT
AER LINGUS	AMERICAN			R
AEROFLOT	PAN AM			M
AIR CANADA	TWA			M
AIR-INDIA	TWA			R
AIR MICRONESIA	ALOHA		10	
	CONTINENTAL		30	
AIR NEW ZEALAND	AMERICAN		7.5	
ALITALIA	USAIR			M
ALL NIPPON	TWA			R
ALOHA	AIR MICRONESIA	10		
AMERICAN	AER LINGUS			R
	AIR NEW ZEALAND	7.5		
	CATHAY			R
	FINNAIR			R
	MALEV			R
	QANTAS			M
	SINGAPORE			R
AMERICA WEST	ANSETT		20	
ANSETT	AMERICA WEST	20		
AUSTRALIAN	UNITED			R
BRITISH AW	DELTA			R
	UNITED			M
CANADIAN AIRLINES	MIDWAY			R
CATHAY PACIFIC	AMERICAN			R
CONTINENTAL	AIR MICRONESIA	30		
	SAS		9.9	M

(TABLE 4:) [Continued]
(Strategic Alliances of American Carriers in the Airline Industry)

DELTA	BRITISH AW			R
	SINGAPORE	2.8		M
	SWISSAIR	5	4.6	M
FINNAIR	AMERICAN			R
GULF AIR	TWA			R
HAWAIIAN	JAPAN AL		25	
JAPAN AIR LINES	HAWAIIAN	25		
KLM	NORTHWEST	14.9		
MALEV	AMERICAN			R
	PAN AM			R
	TWA			R
MIDWAY	CANADIAN AL			R
NORTHWEST	KLM		14.9	
PAN AM	AEROFLOT			M
	MALEV			R
PHILIPPINE AL	TWA			R
QANTAS	AMERICAN AL			M
SAS	CONTINENTAL	9.9		M
SINGAPORE AL	AMERICAN			R
	DELTA	5	2.8	
TRANS WORLD	USAIR			M
UNITED	ALITALIA			R
	AUSTRALIAN			R
	BRITISH AW			M
USAIR	ALITALIA			M
	TWA			M

KEY: *=PLANNED; **=SUBJECT TO REGULATORY APPROVAL; M=WIDE-RANGING MARKETING ALLIANCE; R=ROUTE OR MARKET SPECIFIC ALLIANCE; J=JOINT VENTURE; C=CARGO; MAN=MANAGEMENT CONTRACT

SOURCE: Adapted from: Jennings, Mead. "Strategic Illusions", AIRLINE BUSINESS, August, 1990, pages 27, 28 & 30.

British Aiways, but no equity is involved between or among any of the four carriers.

USAir has two partners, Alitalia and TWA, but no equity is shared between or among the three carriers.

While Continental and Air Micronesia hold first place in the highest percentage of equity (30%) held in each carrier, Japan Air Lines and Hawaiian Airlines run a close second with 25% each. The smallest equity position is that of Delta with only 2.8% of Singapore.

These equity holdings are looked upon by some as a method of cementing the relationship between two airlines for the long run. Those who oppose equity swaps do not see the need for the investments. To the opponents, the investments are nothing more than wasted management time and an inappropriate use of investors' money. To many, equity alliances are becoming a symptom of airlines in distress.
Others see them as defensive postures. Delta readily admits that the 5% stakes it sold to Singapore and Swissair helped to fend off takeover attempts which were in the wings just before the alliance took place. The equity alliances of U.S. Major airlines are illustrated in TABLE 1.

FREQUENT FLIER PROGRAM/ALLIANCES

How can an airline play the passenger number-game and win? However an airline wins new customers - - - merger, consolidation, buyout, takeover, route purchase, new authority, discount fares, or other promotional programs - - - it must retain them as customers. One of the current favorite methods is the frequent flier program. This program allows a passenger to bank his/her flight miles for the purpose of qualifying for a free trip for the passenger, his/her spouse or children, free rental cars, hotel accommodations or some other discounted fare.

DOMESTIC CARRIERS: It should be remembered that a Frequent Flier Program is a specialized Marketing Alliance directed at the problem of customer retention. For instance, Delta Air Lines' frequent flier program is supported by a partnership agreement with seven international air carriers. These air carriers, except Japan Airlines, allow the passenger to earn 100% of their actual mileage in Economy Class; 125% - 150% in Business Class and 150% - 200% in First Class.

Delta also has partnership agreements with three national car rental firms and six national/international hotel chains. Passengers are eligible to earn 1,000 miles bonus credit each from the car rental firms and/or hotels.

Continental Airlines' Frequent Flier Program is called **ONEPASS** and includes ten national/international airline partners. Continental also has agreements with six major car rental firms. Its hotel accommodations include eight major hotel chains that offer 500 frequent passenger miles per stay at the published retail or corporate rate. These hotels offer 500 miles per stay at the published retail or corporate rate.

United Airlines has a large compliment of one dozen airline partner firms through which a passenger can earn Frequent Flier mileage. A 25% mileage bonus is available for a paid Business Class reservation and 50% bonus for paid First Class travel on United. If a passenger charges his United flight ticket, he will receive one mile for every dollar charged one of nearly half-a-dozen credit cards.

Five air carriers participate with American Airlines. American's other alliance agreements include the two leading car rental firms and six major hotel chains.

USAir, in addition to its Frequent Flier Program which seems to be a stand-alone program that is not associated with any other airline company, has segmented its total market into several sub-markets. Two of the more prominent segmented programs are Military Fares and Senior Savers.

Northwest Airlines' Frequent Flier Program/Alliance carrier partners include three major air carriers, five hotel chains and three car rental firms.

Pan Am, on the other hand, had only a single Frequent Flier Alliance partner, United Airlines. It offered accommodations through Intercontinental and Forum Hotels. It was possible to earn 1,000 flight miles per night for as many as seven nights through hotel accommodations at the Intercontinental Hotels and half that many for staying at the Forum Hotels. Automobile rental service was provided three car rental agencies.

Trans World Airlines has Frequent Flier Alliances with four air carriers and two car rental agencies. Hotel accommodations and rental cars that ear bonus flight miles (500 per night) are only available through one hotel or either car rental firm.

One foreign carrier was willing to share information on its Frequent Flier Program. ANA All Nippon Airways' **GOLDPASS** provides all of the benefits of an American carrier, but you must earn your frequent flier miles on ANA All Nippon Airways exclusively.

INTERNATIONAL FOREIGN CARRIERS. British Airways has launched its Latitudes (Frequent Flier) Programme; Virgin Atlantic has its Freeway

(Frequent Flier) Programme; KLM is investigating a "Loyalty (Frequent Flier) Programme" and while domestic laws have prevented Lufthansa from establishing one, anything could emerge from its partnership with Air France.[4]

It is interesting to note that it was Virgin Atlantic's marketing director Chris Moss who described the FFPs as being ". . . bribes and free tickets are as blatant a bribe as we could think of."[5] Virgin Atlantic's Freeway Programme significantly expanded the point (miles) collection opportunities by including not only another airline (Gatwick-based Dan-Air) but a hotel group, a car rental chain, London City Airport, a bank, an insurance company, a petrol station chain as will as duty free sales outlets.

By the same token, Freeway has expanded its redemption opportunities as well. Passengers can redeem their accumulated points/miles for such activities as hot-air ballooning, health clubs, power boating, flying lessons, yachting, golf tuition, and gliding as well as free flights.

The significance of the Frequent Flier Alliance Programs can be seen in the growth of the mileage and, consequently, the liability of the program. **TABLE 2** illustrates the U.S. mileage accumulation between 1981 and 1990.

The growth in the FFP mileage portends a situation that could grow into a problem for the airline industry. The "Good News" part of the problem is that a joint study by the U.S. General Accounting Office and the Internal Revenue Service estimates that the FFP plans account for $9 billion of the $115 billion in revenue generated by business travel in 1988. The "Bad News" is that these same programs generated a

TABLE 2

GROWTH IN U.S. FREQUENT FLIER PROGRAM MILEAGE

BETWEEN 1981 AND 1990

	1981	1985	1990
Cumulative total miles earned (billion)	86	430	855
Cumulative unused miles (billion)	62	310	650
Individual members (million)	1.8	7.4	27.1
Total program memberships (million)	2.0	16.6	81.0
Number of programs per member	1.1	2.6	4.6

Source: Adapted from: French, Trevor. "Better By Miles," Airline Business, (p. 37), Alexandria, VA, October, 1991.

600-billion mile contingent liability of outstanding awards.[6] Some consolation is provided by the fact that (1) 25% of the awards are never redeemed; (2) capacity controls and award limitations have been refined and (3) the capacity used by awards is too small to displace revenue passengers.[7] (Jennings, Aviation Business).

TWA estimates the liability of its unredeemed awards of 162,718 miles at $10.9 million. American's AAdvantage has a liability of 2.5 million redeemable flights at a value of $133.6 million. One of the methods of eliminating a portion of this liability is by establishing an expiration date for the awarding of free tickets. All of the majors except Delta and Continental have implemented this method of "accelerating the burn-off"[8]. A closer look at the situation in terms of members, free tickets awarded and the share of the traffic that is flying free, within the American domestic airline industry is provided in TABLE 3.

TABLE 3

U.S. FREQUENT FLIER PROGRAM:

MILEAGE PROGRAM STATUS

PROGRAM	MEMBERS	FREE TICKETS AWARDED	SHARE OF TRAFFIC FLYING FREE (%)
American	14.2	975,000	4.6
United	13.3	1,200,000	5.6
Delta	10.7	912,000	NA
Continental	9.1	200,000	2.9
Northwest	8.1	623,000	NA
USAir	7.8	1,000,000	5.8
TWA	6.1	311,309	4.6
Pan Am	2.7	402,000	5.7
America West	1.2	125,000	3.7
Midway	0.7	81,000	1.2
Southwest	0.6	168,000	1.7

Source: Adapted From: French, Trevor. "Better By Miles," Aviation Business, Alexandria, VA., (p.38), October, 1991.

STRATEGIC ALTERNATIVES

In addition to strategic alliances, there are many other methods available to carry out perceived future market opportunities. In addition, to those already mentioned - - - mergers and acquisitions; geographical (regional) alliances; marketing alliances, computer reservations system (CRS) consortia - - - must be added the formulation of trading blocs such as the "United States of Europe - - - the European Economic Community (EEC) of 1992" and the European Free Trade Area (EFTA) which is the EEC's largest trading partner with six countries (Austria, Finland, Iceland, Norway, Sweden & Switzerland).[9]

In Europe, London's two main airports, Heathrow and Gatwick, are the two busiest international airports in the world.[10] Britain also has more than 20 major regional airports -serving such cities as Belfast, Birmingham, Cardiff, Glasgow, Leeds, Manchester and Newcastle. Tying into an extensive domestic network, they also have direct international links.[11]

There are more than fifty (50) airlines operating in the United Kingdom, handling approximately 26 million passengers annually and, in 1988, the UK's airports shipped nearly 800 thousand tons of cargo.[12]

However, there are only three domestic carriers in the United States that are already putting the various alliances, mentioned above, together and who have the best chance of survival and profitability over the long term; i.e., American, Delta and United. These three airlines have the greatest probability of survival and profitability because they have the CRSs, the large dispersed hubs, the equipment is either on hand or on order, and their international routes are growing.

American has gradually become the major U.S. Carrier in Miami. American has a 29-point Caribbean system that is the largest of any domestic airline.[13] American's purchase of Eastern's Latin routes will give it control of a 20-city network in Central and South America.[14]

By comparison, British Airways and Air France have positioned themselves better than even American, Delta or United. They command over 95% of their home markets. American and Delta control 15% -18%.[15] Other European carriers are following British Airways' and major U.S. air carriers' lead who are rushing to gain access to Western European gateways before 1992. KLM took a large stake in Northwest and a small share of Air UK. Swissair and SAS have agreed to a 10% share of each. Air France and Lufthansa formed their own alliance.[16]

The smaller carriers must rely on international traffic to grow and are being very creative in reaching for ownership and alliances. For example, SAS is now allied with Continental in the U.S.; Lan-Chile in South America; Swissair in Europe to tap the Middle East and Africa; and Thai in Asia. Another strategy of SAS's Jan Carlzon is that he has adopted former United Chairman Dick Ferris's concept of building a door-to-door travel network with hotels, reservations systems and car rentals. All of this links together information distribution systems, ground transportation systems and airport ground services.[17]

DOMESTIC EXAMPLE: USAIR

Strategic alternatives include retreat/retrenchment as demonstrated by USAir's recent actions. After two years of losses totalling $837 million, frustrated by criticism from regulators and their own pilots regarding inconsistent international growth plans, not to mention being belaboured by the media over an ill-conceived, poorly implemented takeover strategy in the late 1980s of Pacific Southwest Airlines (PSA) and Piedmont Airlines, USAir is making some changes in its corporate strategy.[18]

The airline purchased more slots and gates in Washington and New York from Continental for $61 million in an effort "to build on its strengths" according to Seth Schofield by concentrating on the East coast of the United States (see TABLE 4). In addition, London route authorities from Baltimore and Philadelphia have been bought from TWA for $50 million and an agreement to manage the Trump Shuttle has been struck. The Department of Transportation has approved an agreement whereby USAir could pay up to $16 million for a 40 per cent interest in the new shuttle operation and a 10-year management contract with an

TABLE 4

DAILY DEPARTURES FROM USAIR HUBS

Hub Location	Number of Departures
Baltimore	111
Boston	87
Charlotte	351
Indianapolis	63
Philadelphia	164
Pittsburgh	343
New York (LGA)	97
New York (Newark)	72
Washington National	81

Source: Adapted from: Jennings, Mead. "Strategic Retreat", Airline Business, Alexandria, VA, (p. 37), May, 1992.

option to buy the shuttle outright after four and one-half years.[19]

According to Seth Schofield, Chief Executive of USAir, the idea is to concentrate new domestic and international growth on the carrier's primary hubs along the east coast. The international growth the carrier is most preoccupied with is that which might come from marketing alliances. USAir and Air Canada entered into an alliance in late 1991 which, so far, has amounted to little more than a handshake. However, Mr. Schofield, without giving details, insists that a deal with Air Canada will produce additional revenues for both sides and, as an example of the next generation of marketing alliances, is applicable to any alliance with European carriers. It is believed that USAir's strategy of an east coast business market coupled with the development of an international alliance is workable but only if costs remain low and fares stay out of the discounting realm.[20]

CONCLUSION

U.S. domestic air carriers are going to have to become more involved in strategic planning in order to develop **strategies of globalization for each of its markets** and a **MASTER STRATEGY** for the company as a whole. The United States accounted for 330 million or 39.3% of the passengers enplaning world carrier systems in 1988.[21] Air carriers of the world are beating a path to the front door of America. These non-domestic carriers seek any door that might provide access to the U.S. passenger market (they buy a piece of an American airline firm - - -**EQUITY ALLIANCE**; or look for a window of opportunity [share a computer reservations system (**CRS**)]- - -develop a **MARKETING ALLIANCE** or a **FREQUENT FLIER PROGRAM/ALLIANCE**) to squeeze through.

However, once the dust has cleared, the air under the wings of the future airline industry will be provided by three elements: (1) Service (**MARKETING ALLIANCES**), (2) Ownership (**EQUITY ALLIANCES**) and (3) **FREQUENT FLIER PROGRAM ALLIANCES**. Given these three elements, the direction of the industry today and baring interference by governmental bodies (i.e., re-regulation), there will be true worldwide mega-carriers by the year 2000. Whether mega-carriers will provide additional services, conveniences, lower fares, and a greater variety of destinations or whether they will be regional/hub monopolies with high fares, limited services and fewer destinations remains to be seen.

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