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Taking your airline to new heights

SkyTeam: Caring More About You

A Conversation With Leo van Wijk, Chairman, SkyTeam

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SILVER LINING

Identifying suitable airlines with which to partner is multifaceted. The process can be simplified with appropriate knowledge and tools.

By Geoffrey Southgate | *Ascend* Contributor

The past decade has been challenging for the airline industry. But behind that dark cloud there's a silver lining. It just had to be found. Many carriers around the world found it through building strong, long-term partnerships with one another.

Partnerships and mergers present an opportunity for strengthening airlines' chances of long-term survival because they boost revenue generation through network sharing. They also promote cost reductions as a result of collective buying power and economies of scale.

Most airlines have reached out to other carriers to build that ideal global partnership, whether through basic interline or codeshare agreements or through a more-formal alliance relationship with one of the three global alliances. Each solution offers pros and cons, but not all partnerships are right for all airlines.

For some, it's more than aligning. It's a question of, "Why join them if I can buy them?" That's where a merger or mega-merger comes into play.

"The trend toward consolidation will become more intercontinental in the next years than is currently the case," said Stefan Lauer, the head of Lufthansa's subsidiary airline brands. "It remains an exciting topic."

The industry has witnessed a lot of consolidation during the past 10 years among some of the most powerful airline brands. It has experienced higher intensity in recent years with the announcement of multiple mergers … whether through investment or mutual agreement. Those most prominent being:

- Air France-KLM,
- America West-US Airways,
- American Airlines-TWA,
- Avianca-TACA,
- British Airways-Iberia,
- Delta Air Lines-Northwest,
- LAN-TAM,
- Southwest-AirTran Airways,
- United-Continental.

Key Drivers

Through extensive research studies, *Sabre Airline Solutions*® revealed several key drivers for airline mergers, including:

- Improves capacity utilization,
- Enhances coverage of sales force,
- Provides the opportunity to consolidate staffing levels,
- Improves economies of scale,
- Smoothes out seasonal sales trends,
- Offers access to new suppliers or distributors,
- Provides a gateway to new technology,
- Potentially reduces tax obligations,
- Streamlines maintenance.

Latin Forces Airline mergers have been more popular in the United States and Europe until now with Latin America's LAN-TAM and Avianca-TACA following suit.

While all airlines focus on many of these drivers for success, attempting to do this on their own presents significant challenges. Uniting with others helps share the risk and ultimately increases the opportunity for success. Merging with another airline is one way an airline can strengthen its market position, secure economics and have a tighter control over its destiny.

Making It Work

Shopping for an airline to buy or partner with is not an everyday occurrence. The investigative process can be lengthy and involves multiple interest groups. In addition, there are legal and government regulatory concerns to be considered. Added to these daunting hurdles is the unfortunate knowledge that history is littered with mergers or partnerships that have, for many reasons, failed.

Choosing the right partner or partners is therefore paramount to the success of the merger. There are various factors to take into account in finding that right partner or potential takeover candidate before considering the overall cost and investment needed.

To be successful, the ideal candidate should have a network or schedule structure that is compatible. It must possess markets with potential growth opportunities. Expanding a network is costly, so successfully leveraging existing markets that blend with an airline's own business philosophies, as well as quickly create revenue opportunities, are essential to the success of the merger.

The prospective airline should also have similar processes and a culture that is easily adaptable to ensure a smooth transition between companies. Speed for merging seems to be a lesson from the past. The longer the merger process, the more challenges. Good examples of mergers that have moved rapidly include Delta Air Lines-Northwest, where technology, processes and logistical locations were completed well within a two-year period. United-Continental expects to complete their merger in 12 to 18 months. But for some airlines, such as US Airways, pilot contracts have dragged out for more than five years, creating many challenges for employees and the new merged company.

"There have been more bad mergers than good ones," said Gordon Bethune, former chairman and chief executive officer of Continental. "It can take decades for airlines to fully merge operations, and many mergers fail to produce the benefits that managers foresee and end up only eliminating flights and opening up opportunities to more nimble competitors."

Using a consulting service to investigate and research the possibilities of a potential partnership can help objectively look at potential candidates. An experienced consultant will delve deep to uncover historical details, trends, successes, failures and potential future opportunities that will provide valuable content to identify a viable candidate and help move forward with the merger.

Consultants from *Sabre Airline Solutions* can determine how well a potential partner will logistically integrate within the established airline. They also identify possible challenges that could loom on the horizon.

Public Perception

While the theoretical review of what makes a merger work is important, one other area is often overlooked. How will public perception view this merger? Public perception can factor into the success — or failure — of a joint venture.

In the past, the media has been critical of airlines, and businesses in general, that want to partner with their competition. Especially damaging is the idea that airlines are "buying" competitors to create an "unfair" advantage in the marketplace, which contributes to negative public sentiment.

An article printed in London's *Telegraph* in September harshly criticized British Airways and its merger with Iberia, claiming the merger wouldn't work.

"Mr. [British Airways CEO Willie] Walsh's pursuit of consolidation is more aggressive than most, but his belief that it is the answer to the industry's chronic problems is widely shared," the article said. "The rationale goes like this: there is too much capacity. Too many airlines, too many planes. Only by making acquisitions will airlines be able to cut costs sufficiently to restore profitability. The economic slowdown has already spurred a renewed push for consolidation: as well as the BA-Iberia deal, United Airlines and Continental are joining forces in the United States. Will it work? I wouldn't count on it."

And then there are those who believe passengers are victims of consolidation.

"Perhaps the biggest losers among any merger are the die-hard loyalists — the elite frequent flyer who has sacrificed to maintain allegiance to one airline," wrote Joel Widzer in a Forbes.com article. "Elite flyers can suffer much the same way that employees will suffer from reduced seniority. The newly merged airline will transport a larger pool of elite flyers with reduced capacity, meaning that the real prize of elite membership — first-class upgrades — will become harder to get. Essentially, any airline merger will downgrade elite membership with over capacity, upsetting the already tenuous relationship between elite frequent flyers and loyalty programs. This could lead to a loss of loyalty that airlines can ill afford."

You can count on everyone having an opinion about this industry whether good or bad. But in the long term, public sentiment can affect the potential success of the proposed airline merger no matter how perfect the situation appears. This drives the need for prospective partners to proceed with caution and take all aspects of the joining businesses, including the social side, under extreme consideration.

The Perfect Partner

Mergers have multiple faces, but generally speaking, a merger is buying a controlling interest in or outright purchasing another airline or even making a mutual investment in each other.

Generally, airline mergers have an amicable approach, after all this is not viewed as some hostile takeover bid, which is witnessed in other areas of the corporate world. Strategically, merging needs to make sense for both airlines to gain synergies and improved efficiencies. It must be determined, when weighing all factors, which companies make ideal partners.

Networks are the bread and butter for airlines, and this is the first area they must consider when defining their merger ambitions. The Delta Air Lines-Northwest merger, and even the United-Continental merger, highlight clear, distinct network synergies that, when combined, complement each other.

The new Delta Air Lines was able to add to existing trans-Pacific routes that would support its domestic operations and strengthen its European presence, rounding off a solid global network, which complements its alliance membership in SkyTeam.

The United-Continental merger leverages Continental's solid South America services and intra-Pacific/Asia connections with United's trans-Pacific presence.

Added to these market offerings, both merged airline groups have a strong alliance association that now can truly capture new market segments while effectively leveraging combined fleets, crews, maintenance operations and technologies.

For mergers such as British Airways and Iberia, which have mutually formed a cooperative operation via holding company IBA, networks are closer linked or even overlap in some key markets. It was their combined international services that made for a robust business against the competition, keeping customers within a single, shared, seamless journey for longer, thus maximizing revenue opportunities for the holding company. This can also be said of Air France and KLM, which share many similarities of operation but are now strengthening both airlines through shared European services and international operations.

Another factor when identifying the right partner is how to achieve seamless processes and services. Combining two previously competing cultures presents a major challenge. As seen with British Airways-Iberia, it was made easier because both airlines operated within the **one**world alliance under common service practices.

Air France and KLM also worked together as members of the SkyTeam alliance prior to merging. Thus, from the onset, they had like standards that made the merging of cultures slightly easier through common alliance standards.

Merging with a partner in an alliance appears to be a theme. Perhaps this is a key ingredient for identifying a potential partner that understands and operates using similar service processes and has a complimentary network.

Compatibility is the key for establishing a smooth, successful airline merger. This is especially true when addressing another critical factor … technology.

Merging Technology

Combined airlines can and do represent better buying power, one of the main benefits of a merger. Increased buying power equals reduced costs, whether for modern aircraft or IT systems. But what happens when these joining entities have two of everything once they merge?

Airline technology can be complicated given that it spans all areas across the organization — from reservations, airport check-in and aircraft support to planning and scheduling, network management, and Web services. These are all duplicated when two or more airlines come together.

Essentially, there are four technology options to consider with a merger:

1. Dominant partner — The governing airline in the merger dictates or directs that its solutions and processes are the new standard.
2. Best-of-both — Both airlines collectively identify the best solutions from their existing systems and create a new platform based on the combined technology.
3. The consultant — Industry experts work on behalf of the joining carriers to identify a proven alternative that provides a complete, fully managed, supported turnkey solution. The consultants provide a fully integrated platform that addresses all requirements of the new organization. Going forward, the new organization would utilize and leverage new technologies and integrate new processes as part of the continuing solution evolution.
4. Standalone — The airlines operate as separate entities, running independently, but seamlessly, as partners of a joint venture. They would continue using their

existing platforms and processes the same as many airlines do today within alliances.

Once the technology direction has been set, airlines must focus on how to implement the IT strategy to benefit the new organization(s). They can opt to do it themselves through an in-sourcing program or they can subcontract it through a number of outsourcing options.

In Sourcing

The new airline structure may elect to build its own technology platform to suit all airlines involved. Many airlines view this as a way to take full control of their destiny. For example, Air New Zealand has its own reservations and departure control systems that have evolved through the years, integrating with new industry requirements and taking advantage of new technologies such as the Web. Similarly, Emirates operates its own in-house solution called Mercator. Many airlines have also developed their own loyalty solutions.

A downside to this approach is that technology is extremely dependent on the overall success of the airline and has to compete with other business units for valuable investment and operational dollars. It requires a capital outlay as well as dedicated resources for maintenance, upgrades, enhancements, etc., to remain modern.

Top Airline Brands Merging isn't new to carriers such as American Airlines and Air France, and it continues to be a popular practice among some of the most prominent airline brands.

Outsourcing: External Suppliers

Airlines often partner with external suppliers, such as *Sabre Airline Solutions*, that employ industry-experienced experts with an in-depth understanding of airlines' needs and requirements.

A substantial benefit includes being part of a large airline community. This gives member airlines an opportunity to help define the direction of the solutions they use and offers a cost-shared option for acquiring advanced technology.

External suppliers offer a wider range of services and solutions, allowing an airline to better align its IT strategy with its business objectives and goals. External suppliers also offer consultative services that help identify areas for cutting costs.

Alliance Outsourcing

An alliance can outsource services to an external supplier or to another member airline, the latter scenario a rare but nonetheless viable option. For example, it would work with other member carriers to determine if there's a solution that can be utilized by another member airline or mimicked. The alliance could instigate on behalf of its members to develop a necessary solution. The airline then being a single point of contact can decide whether or not to subscribe to that solution.

Additionally, the alliance could recommend services or platforms to its current or potential members to ensure consistency across the organization.

Finally, the alliance could mandate services as part of an airline membership, again, to remain consistent throughout the organization.

Outsourcing: Airline To Airline

Although a rare option, there are situations where an airline outsources certain areas to another airline. In some Asian countries where the home airline owns the

GDS or dominates the market, it can also supply the systems for other local airlines.

Within a merger scenario, it's possible for two airlines in a cooperation to swap or share solutions within the merged organization. This typically is part of the initial negotiation that occurs between airlines in the process of merging.

Even for what outwardly appears to be a simple passenger-service solution, the complexity is massive. It spans many involved and adjacent service components that make up a fully rounded solution.

Sabre Airline Solutions has made significant investments to help solve some of these challenges, including:

- The *Sabre® ASx℠ Airline Services Exchange* offers a state-of-the-art custom-domain rules engine, toolkit and application standards that utilize real-time data across an airline's enterprise. This approach allows airlines to detect and proactively manage patterns in its business. This applies to both merged airlines that need superior data models to help strengthen their integration, or to airlines that need to marry their application to existing *Sabre Airline Solutions* technology.
- *SabreSonic® Customer Sales & Service* multi-carrier platform capabilities enable a group of airlines to operate within a common umbrella seamlessly. In doing so, they still maintain their individual identities. This solution is ideal for airlines that, for regulatory requirements, must remain independent but need to operate seamlessly within a family group or holding company.

Merging Cultures

Merging cultures of two previous competitors into a single, unified team can present numerous challenges. For instance, if a work group, such as pilots and flight crews, becomes disgruntled as a result of the joint venture, they can block merger talks and refuse to sign new contracts in protest of perceived disadvantages from the proposed merger. It took US Airways five years to resolve a pilots' dispute over seniority following the merger with America West.

Employees have considerable influence on the successful outcome of a merger. Often times, one group of employees feels like the underdog; as if the group is at a disadvantage compared to the other group. And there's always the fear of layoffs due to duplication of resources. That type of negative environment causes anxiety and insecurity as well as puts a damper on morale. It breeds negativity, which leads to a dysfunctional environment.

To avoid angst among workers, leaders from all joining entities must open the lines of communication with employees. They should always be spoken to in a direct, upfront manner. Employees shouldn't read about a major event impacting their company or hear it on the news.

Executives from joining airlines should come together as a unified executive team when addressing employees. They should be as forthcoming as possible about the details, and they should give ample opportunities for employees to ask questions. From the onset, employees should feel like part of a winning team. That comes directly from the trust they have for management and the enthusiasm that has been displayed by managers.

Next would be to get through the process quickly. Lengthy, protracted mergers lead to an increase in disgruntled employees and a loss of productivity. The need to rapidly provide a sense of unity within the new organization, again, through open conversations with clear direction, aids the creation of team spirit as the merger progresses forward.

Those that acquire their competitors outright must determine the location of the new organization. For example, Delta Air Lines defined its existing headquarters in Atlanta, Georgia, as the new combined location. Similarly, United and Continental will share locations for specific functions in both Chicago and Houston, thus providing a cultural plus for employees in both camps as well as opportunities within the new organization for enhancing careers.

HighLight

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— Stefan Lauer, head of Lufthansa's subsidiary brands

New opportunities for employees of the merged organization can abound. Airlines can better leverage employees from many countries to contribute to the new sales and marketing organization, thereby addressing any cultural sensitivities.

If the new organization deems it best to implement a completely new technology platform that is most suitable for the combined carriers, there are opportunities to overcome cultural differences. For example, if all employees are facing retraining due to an overhaul of technology and processes, unification could be quicker and smoother, given that now everyone is equal in the new organization.

A Smooth Ride

Merging airlines is a complicated, complex process. Juggling myriad aspects can create a nightmare for prospective investors. However, those who learn from others' mistakes as well as take advantage of industry expertise will find that joining forces can be a smoother exercise.

The consulting team at *Sabre Airline Solutions* is prepared to fully support airlines and their goals for growth or expansion. When joining an alliance or acquiring another airline, these industry experts provide objective consultation to aid in the decision-making process throughout the engagement. They will help identify the right technology platforms that best suit the new organization and its goals, whether in house or outsourced.

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