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A Conversation With...

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# The Route to Liberalization

*With government restrictions limiting cross-border ownership of airlines preventing full mergers, airline alliances have provided an alternative that could set the stage for more open skies in the future.*

■ By Phil Johnson | Ascend Staff

One of the most obvious examples of open-skies philosophies in action today is the proliferation of airlines that have joined one of the three primary global airline alliances: Star Alliance, SkyTeam and oneworld.

Last year, these three global alliances — as a group — accounted for approximately two-thirds of worldwide airline revenues.

Not only that, but regional airline alliances are now being formed in various local geographies. And it's no wonder: Alliances of all types allow airlines to enhance revenue and scope — sometimes significantly — without the necessity of having to commit to further major financial investments in aircraft and labor.

And even though global alliances don't actually constitute open skies per se, they represent the next best thing: greater reach on a worldwide scale, which is precisely what these airlines want to achieve in their global operations.

In helping to overcome international barriers, both codeshares and alliances essentially promote open skies. By definition, codeshares are bilateral agreements and alliances are multilateral agreements. And although bilateral agreements only provide open skies between the two countries involved, the multilateral effects of the larger airline alliances have been far reaching in moving the industry closer and closer to broader, global open skies.

The ultimate alliance relationship between airlines is a merger — or at least an equity tie-in between carriers. Most prominent among current global examples is the Air France/KLM relationship, under which Air France has essentially acquired overall control of KLM's assets. Airline alliances, when all is said and done, are basically forms of cooperation — and total consummation of that cooperative relationship would logically be a merger.

Short of actual financial merger or equity relationship, however, no other mechanism



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Given the enduring restrictions on the airline industry, global alliances have played a key role in helping move toward a more open industry. Since the founding of the first airline alliance in 1997, these global entities have allowed member airlines to operate more closely in terms of pricing and scheduling.



comes as close to projecting a semblance of true worldwide open skies than the global airline alliances. In the future, as more airlines negotiate cross-border equity relationships with other carriers, open-skies barriers between the nations involved are likely to melt away.

Even though the global alliances encompass some of the world's best-known airline brands, there are still a number of airlines around the globe that are either unaligned or are entering somewhat initial stages of aligning within regions.

One of the most recently formed examples of a regional airline alliance is Arabesk in the Middle East, consisting of EgyptAir, Gulf Air, Saudi Arabian Airlines, Middle East Airlines, Yemen Airways, Oman Air and Royal Jordanian. And the concept of regional airline alliances is also being carefully considered in other regions such as South America.

The rationale of the regional airline alliances is pretty simple: Gain all of the benefits of the global alliances, just on a regional scale — but also combine financial resources and marketing ingenuity to effectively compete within the region against global players.

It's a promising concept. And it's also manifested in another offshoot of the alliance philosophy with AirAsia — which has basically franchised itself separately within Thailand, Malaysia and Singapore by divvying up independent AirAsia branches able to operate semi-autonomously as entities in each of those individual countries. Basically, this arrangement enables AirAsia to get around cross-border ownership restrictions in the various nations involved.

One of the primary reasons the franchise/single-country idea is particularly relevant is because most nations today continue to restrict the level of foreign ownership allowed in any of the major parts of their vital transportation infrastructures, particularly airlines.

This is why in the United States, for example, no foreign entity is legally permitted to own more than 25 percent interest in the publicly traded stock or voting rights of any U.S.-based airline. Movements are afoot to increase that permissible foreign ownership to 49 percent, but political as well as national security issues could short circuit such foreign-ownership expansion ideas from ever becoming law.

Among the upshots may be an extension of the franchise concept on the parts of foreign-owned airlines such as British-based Virgin Group, which is investigating the possibility of lending its name to a U.S.-based operation structured to adhere to the U.S. domestic-ownership requirements.

Wherever there's a viable market that needs to be served — or a greater competitive environment to be fostered on certain routes — private enterprise will find a way. Airline

alliances have proven to be effective vehicles to allow and encourage this service.

Furthermore, in today's globally competitive airline environment, instead of carriers competing against other carriers, the situation has evolved, to a great extent, to a worldwide pattern of alliances competing against alliances.

From a free-trade point of view, alliances essentially allow airlines to circumvent the restrictions resulting from a bilateral environment (consisting of many small open-skies agreements between individual countries around the world, which tend to be restrictive), as opposed to the more-or-less global open-skies environment many envision in the future.

### HIGHLIGHT

**Wherever there's a viable market that needs to be served — or a greater competitive environment to be fostered on certain routes — private enterprise will find a way. Airline alliances have proven to be effective vehicles to allow and encourage this service.**

Contrast the situation in the airline industry with that in, say, the automotive industry — with Daimler-Benz having merged several years ago with Chrysler Corp. to form DaimlerChrysler — or in the banking industry, with ABN Amro NV of Amsterdam acquiring LaSalle Bank in Chicago, along with other prominent U.S. properties.

Airline industry executives have sometimes complained quite vocally about being singled out for worldwide restrictions while companies operating in other huge industries are allowed to merge almost at will.

Yet at least part of the logic behind cross-border airline-merger restrictions lies in the fact that the airlines are not only directly involved in international commerce, but their capabilities — their preparedness and readiness to transport thousands of people and goods almost anywhere around the world — make the airlines strategically critical to their native countries' range of options in times of national emergency or natural disaster.

A few smaller airline alliances — or codeshare arrangements — have been granted antitrust immunity by certain governmental entities. Antitrust immunity essentially creates a bilateral relationship that is very similar to an open-skies arrangement — because the airlines involved, with antitrust immunity, are

therefore legally permitted to share otherwise confidential competitive data on capacity and prices. That allows the airlines to think economically and boldly plot strategy as if they constituted a single, merged airline.

A primary continuing sticking point in the worldwide movement toward open skies is the situation at London's globally critical Heathrow Airport. Bilateral trans-Atlantic operations out of Heathrow between the United States and Great Britain are limited to two carriers from each country: American Airlines, United Airlines, British Airways and Virgin Atlantic Airways.

This is also a flashpoint in the discussions between Britain and the United States

over U.S. foreign-ownership restrictions that set the upper limit at 25 percent. Any agreement to open up Heathrow will likely include provisions to continue to restrict foreign ownership of U.S. carriers, but the negotiations also revolve around assignment and retention of terminal slots with regard to the various airlines operating out of Heathrow. Without significant expansion of the total number of slots, the Heathrow situation may possibly be destined to remain a symbol and relic of pre-open-skies protectionism for some time into the future.

But from an overall free-trade standpoint, it's only logical that both the United States and Britain — as well as the greater European Union — should continue to strive to find broader means of encouraging competition and economic development. And that includes opening up Heathrow.

That, after all, is what open-skies agreements — benefiting the ambitious participants among the greater global airline industry, as well as the worldwide economic community as a whole — are all about. **F**

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