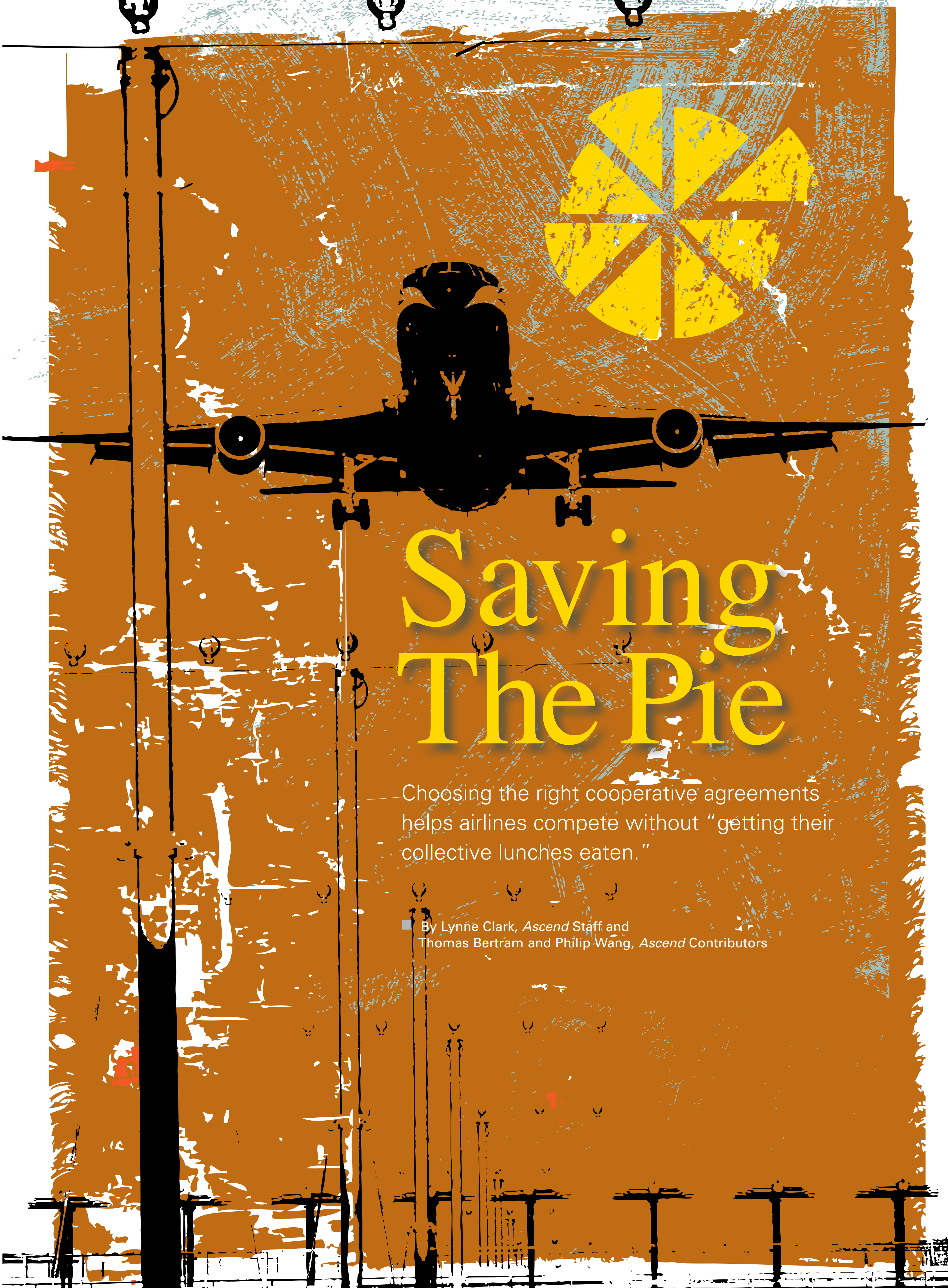

Saving The Pie

Choosing the right cooperative agreements helps airlines compete without "getting their collective lunches eaten."

By Lynne Clark, *Ascend* Staff and
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In their book, "Co-Opetition," authors Adam Brandenburger and Barry Nalebuff say co-opetition "explains how to compete without destroying the pie and how to cooperate without getting your lunch eaten."

It's fair to say that since the dawn of the 21st century, economic conditions have nibbled away at the pie known as the airline industry. From 2001 to 2005, network carriers lost more than US$33 billion, while four of them entered and exited bankruptcy. More recently, in 2006 and 2007, the airline industry returned to modest profitability only to confront rapidly increasing fuel costs and renewed losses last year.

The recent economic downturn and the long-term downward trend in fares create a challenging environment for revenue generation that has even affected previously immune low-cost carriers. In January, Southwest Airlines reported a net loss of US$56 million, compared with a profit of US$111 million a year earlier.

Macroeconomic troubles — such as the recent tightening credit market and housing slump — have generally served as early indicators of reduced airline passenger demand. These are the challenges that have spurred a wave of airline partnership agreements with one objective in mind — to achieve sustainable profitability without partner entities getting their collective lunches eaten.

Sustained profitability depends on a carrier's ability to increase revenues and reduce costs. And one of the most effective ways to increase revenue and reduce cost is cooperation with other carriers. Cooperation among airlines comes in many forms, and the benefits include:

- Network expansion with minimal or small resource investment,
- Increased airline presence in regions not located in their home market,
- Incremental revenue support for specific markets that cannot be profitably served by the airline alone,
- Higher volume interline sales through shared Internet and open-systems opportunities,
- Preferential screen display through global distribution systems and Internet channels,
- Reduced network costs by higher utilization of resources,
- Increased passenger loyalty.

Complexity Drives Partnership Type

Airline partnerships are defined by their degree of complexity, cohesiveness, potential benefits and strategic impacts. An interline ticketing agreement can be a multilateral or special proration agreement, depending on whether the International Air Transport Association standard proration or special proration is used.

Even though frequent flyer program cooperation is often agreed to along with codeshare or alliance agreements, carriers sometimes enter into this kind of partnership without a codeshare or alliance program in place. Codeshare agreements come in many different types including block seats, free sale or tactical-level joint ventures. The alliance can be regional or global. A joint venture is the highest level of inter-airline partnership in terms of cohesiveness but not necessarily in scale and complexity compared to entering a large global alliance.

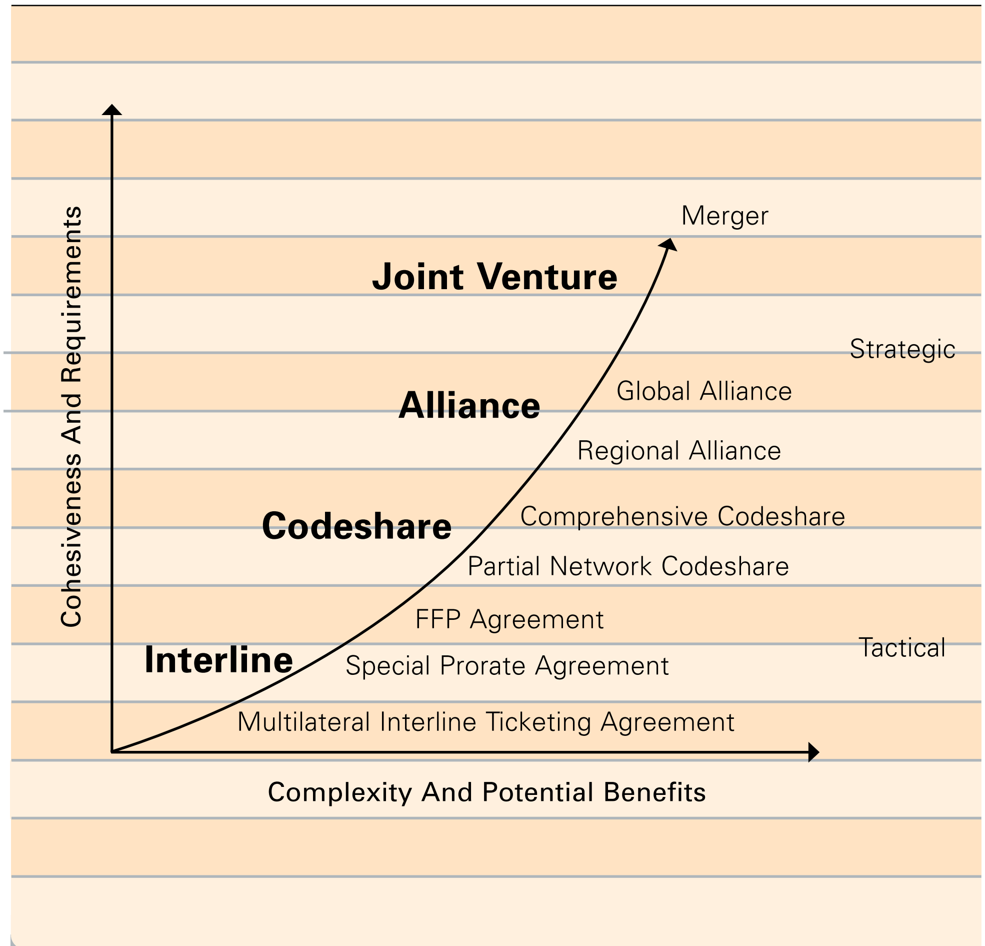
Carriers must have well-defined priorities before deciding the type of agreement that matches the outcome they most desire. Agreements are either tactical or strategic and accomplish different goals including:

- Maximizing profit,
- Maximizing revenue,
- Maximizing growth,
- Minimizing cost,
- Minimizing implementation efforts and investment.

Generally, tactical types of partnerships generate quicker results but have smaller impacts with less effort. Strategic partnerships have larger and more long-term impacts. But the implementation of strategic partnerships takes longer to implement, requires more capital and effort, and poses bigger challenges and risks.

For example, if an airline's top priority is to maximize profits quickly, joining a global alliance may not be the best choice. Instead, the airline should consider implementing a partial network codeshare with separate airlines that target underperforming sectors.

In deciding potential partners, airlines will use industry data, such as market information data tapes, and decision-support tools, such as the *Sabre® AirFlite™ Profit Manager*, to estimate the effect of linking up with different carriers. It is impossible to forecast the profitability of a comprehensive codeshare using a spreadsheet or simple forecasting tool.



Airline partnerships are defined by their degree of complexity, cohesiveness, potential benefits and strategic impacts. Interline ticketing agreements represent the simplest level of cooperation, and joint ventures are the most cohesive and complicated. Mergers, combining two entities into one, are beyond the scope of cooperation.

Compatibility Considerations

Once the potential partnership type is identified, airlines should examine how well they will work in conjunction with one another. Three key areas for evaluation include:

1. Network compatibility,
2. Business compatibility,
3. System compatibility.

To examine these issues, decision makers should evaluate potential partners by asking several questions in each of the key areas:

Network Compatibility

- Coverage — Will the partnership enlarge market reach to meet the demand?
- Connectivity — How well will flights connect at hubs of all partners?
- Capacity share — Will the joint capacity dominate the local trunk market?

Business Compatibility

- Service levels and branding — If the partner is a low-cost carrier, does its services match those of a premium carrier or vice versa?
- Corporate culture — How entrenched is the culture, and how easily will it accommodate a partners culture?
- Products — What cabin classes, in-flight services and frequent flyer programs does the potential partner offer?
- Financial stability — Is the airline willing to take on a troubled partner? What will it cost?

System Compatibility

- Reservations and ticketing systems — Does the partner system enable free sell and interline e-ticketing?
- Revenue accounting system — Can the potential partner handle the type of interline billing system the operating carrier handles?
- Check-in systems — Can the potential partner handle interline through check-in?
- Web sites — Does the partner system have the ability to display, reserve and ticket codeshare flights and multi-leg interline itineraries in top travel portals and partner Web sites?

When integrating information technology systems with other carriers, the key is to use the right systems that work well and directly impact the customer. The primary integration point is with the passenger services systems. A reservation made by a marketing airline must be present in the inventory from the operating carrier's system. Items such as frequent flyer traveler numbers, seat assignments and special service requests need to be present and synchronized in both the operating and marketing carriers' systems. The best method for doing this is using one of the four industry standard codeshare options that have been developed for electronic communication between airline reservations systems. The other best practice from a customer perspective is frequent traveler miles. Best practice is to consistently send data feeds to and from loyalty systems.

Newer and more open systems also help attract partners because the implementation will be easier, faster and less expensive. These types of systems also often mean more sales opportunities and better customer service.

Revenue Sharing

Once a potential partner is analyzed, it should be determined how revenue will be shared. Rather than using the standard IATA prorate methodology, most airlines in a codeshare arrangement will create a special prorate agreement with their partner carrier. This enables more flexibility in determining how the revenue will be split among partners. An analysis of an SPA should take into account the potential new traffic from the codeshare and the potential displacement of passengers and/or revenue on the existing flights.

HIGHlight

It's fair to say that since the dawn of the 21st century, economic conditions have nibbled away at the pie known as the airline industry.

The key to success in setting up an SPA is that there is fairness and balance. An airline needs to balance the potential revenue displacement of carrying a codeshare passenger in a busy market with the additional opportunity of adding an additional codeshare passenger in a more lightly traveled market. In short, SPAs need to be beneficial to both partners.

Once the SPA has been finalized, the next step is to determine how the booking classes will be aligned between the carriers. Each operating carrier is responsible for managing its own inventory, so when the marketing carrier requests a seat on the operating carrier, the operating carrier needs to know how to tell the marketing carrier if the seat is available or not.

The process is handled using translation tables set up in the reservations system. Each operating carrier reviews the prorate agreement to determine where it will point the marketing carrier's booking classes to its own. Ideally, the revenue received by the operating carrier in a booking class from the codeshare passenger should be the same as the revenue the operating carrier would expect from its own customers.

Effect On The Traveling Public

Generally, airline agreements have a positive impact on the traveling public. Passengers have more choices of flights and itineraries to reach the same destination. If the partnership does its job, travelers will find a seamless integration between carriers from booking to check-in to post-flight services.

While partnerships get the kinks out, however, travelers may be confused by different flight numbers for the same flights displayed on airport screens and heard in announcements. In addition, frequent flyer numbers may not be automatically credited by partners, and passengers may have to manually fax the document to partner airlines.

However, airline executives are betting that customers will endure the short-term hardships when they realize the result will be far more travel choices within an alliance than they would have with an individual airline.

It's the travel choices that will ultimately drive more brand loyalty to both the airline and the alliance.

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