Global Airline Alliances - Reaching Out to New Galaxies in a Changing Competitive Market - The Star Alliance and Oneworld

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GLOBAL AIRLINE ALLIANCES—REACHING OUT TO NEW GALAXIES IN A CHANGING COMPETITIVE MARKET—THE STAR ALLIANCE & ONeworld

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This article examines the emergence of the Star Alliance Group headed by United Airlines, which by adding Varig of South America as a partner in late 1997, attained its objective of becoming the first global airline alliance. Then, in July 1998 American Airlines and British Airways received conditional approval to form their own alliance by the European Union’s Competition Commissioner. EU approval was subject to the sale of a certain number of slots at London’s Heathrow airport and the approval of a US-UK Open Skies agreement. In September 1998, oneworld, headed by British Airways and American Airlines, (BA-AA) was launched. This article seeks to examine the components of these new global alliances, their strategic linkages with other airlines, and the characteristics that make them dominant as the airline industry enters the new millennium and beyond.

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I. INTRODUCTION

THE ANNOUNCEMENT in late 1997 that the Brazilian carrier Varig Airlines, the largest airline in South America, had joined the Star Alliance Group, created a strategic commercial threat to its competitors and signaled to other alliance groups that Star has the capacity to be the first truly global airline alliance.\(^1\) Launched officially in May 1998, U.S. authorities have permitted the Star Alliance to proceed, though the European Union Competition Commissioner intends to watch its activities closely following complaints by corporate travel agents that the alliance partners have failed to pass on price benefits to passengers in Europe.\(^2\) The alliance partners in Star, which collectively fly to more than 600 destinations in 108 countries, provide a stellar challenge to other major carriers such as the oneworld British Airways - American Airlines Group seeking to form similar alliances on a global scale.\(^3\) This article seeks to assess the core components of each alliance, the features which have created the competitive advantage the airlines currently enjoy, and the challenges facing them over the next three years as they seek dominance in a new world of global carriers in the new millennium.

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II. VARIG AIRLINES AND THE STAR ALLIANCE

Varig Airlines joined the key partners of the Star Alliance—Air Canada, Lufthansa, SAS, Thai International, and United Airlines—at a time when their nearest competitors, British Airways and American Airlines, were attempting to gain the pre-eminent position in global aviation. Varig Airlines has a fleet of eighty-two jet aircraft, serves eighty-seven cities within Brazil and thirty-five cities in twenty-three countries on four continents. The airline's publicity states that the Star Alliance is "a global air network offering customers convenient world-wide service through global recognition, coordinated schedules, one stop check-in and the most convenient access to more than 600 destinations worldwide." This initiative by the Star partners suggests their main competitors, the BA-American Airlines Group, may find themselves increasingly isolated from reaching their global objectives unless the BA-AA Alliance gains full regulatory approval from the European Commission and the UK government without delay.

American Airlines also faces difficulties in maintaining a viable service on some routes serviced by the Star Alliance. The recently retired Chairman of American Airlines, Robert Crandall, stated that his company is dwarfed by the Star Alliance, which has $42 billion in annual revenue and serves 78,000 potential city-pairs. BA-American Airlines', on the other hand, has $27 billion in revenue and 36,000 city-pairs.

At the time of this writing, British Airways and American Airlines had gained a preliminary ruling from the European Commission granting approval to develop their commercial relationship. This decision is subject to the BA-AA Alliance withdrawing 267 slots at Heathrow airport and reducing frequencies on major hub-to-hub routes over a six-month time period, in addition to the general terms and conditions under which the UK and US governments will proceed with the Bilateral agreement.

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5 See generally McDowell, supra note 3.
III. THE STAR ALLIANCE PARTNERSHIP

The Star Alliance Group continues to extend its global reach with new partnerships including Singapore Airlines of the Singapore International Airlines (SIA) Group, Air-New Zealand (Air-NZ), and Ansett Australia entering the alliance in March 1999. These links are based on an extended code-sharing relationship with twelve other carriers in the Asia Pacific Region. It is noteworthy that United was the only North American carrier that remained on the South Pacific route during the economic recession in the 1990’s when American Airlines, Continental Airlines, Pan-American Airlines, and North-West Airlines withdrew their services.

At present Star is the largest alliance in the world. With Varig Airlines of South America, the Star Alliance accounts for $46 billion in annual revenues, 1450 aircraft, and 232,000 employees, in addition to smaller carriers that are linked closely with other Star Alliance partners. It seems SIA has left the Delta Airlines-Continental Airlines Group so it can act as a major hub in the Asia Pacific Region. The combination of the Star Alliance partnership with other well established and profitable airlines such as Lufthansa, SAS in Europe, and now the SIA Group, suggests it has all the hallmarks of a truly global network, serving Northern Europe, the Asia Pacific region, and North and South America.

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11 See Nic Hopkins, Singapore Airlines has Eyes for Competitor’s Skies, THE AUSTRALIAN, Sept. 12, 1998, at 55; see also Geoffrey Thomas, Air NZ Bid Seen as Bargaining Ploy, SYDNEY MORNING HERALD, Apr. 5, 1999, at 35. SIA, with cash reserves of $2 billion, is bidding with Germany’s Lufthansa to buy into South African Airways, Thai Airways, and China Air. SIA would not reveal if it would make a stake in Ansett Airlines by way of taking up News Ltd’s 50 percent share. See id.
IV. THE ANSETT FACTOR: NEW RELATIONSHIPS-THE POTENTIAL FOR GROWTH IN THE ASIA PACIFIC REGION

Ansett Australia intends to follow a vigorous growth strategy in Asia despite its international arm, Ansett International, incurring a $50 million loss for the 1997 financial year.\textsuperscript{12} Ansett will pursue growth by building frequencies to existing destinations and searching for new opportunities. On June 17, 1997, for example, the carrier launched a twice weekly service to Shanghai with rights to increase the service to six times per week. With the economies of Japan, Korea, Thailand, Malaysia, and Indonesia experiencing severe contraction in May 1998, however, Ansett suspended its flights as new figures pointed to a deepening slump in Asian tourism to Australia.\textsuperscript{13} Ansett stated that its decision reflected the worsening economic conditions created by the Asian currency crisis. Preliminary figures from Australia's Bureau of Statistics indicate that South-East Asian traffic contracted by twenty-eight percent in the first quarter of 1998, with Indonesian and Malaysian visitor numbers down fifty-three percent and thirty-one percent respectively. Tourism from Korea, from which Ansett withdrew its services in Feb. 1998, fell by eighty-one percent.\textsuperscript{14}

On June 11, 1998, the Australian Competition and Consumer Commission (ACCC) granted approval to Ansett Airlines' commercial alliance with Air NZ and SIA for a period of five years, acknowledging that while there were anti-competitive aspects to the alliance, on balance it was likely to have a number of public

\textsuperscript{12} See Michael Sharp, \textit{Ansett: Asia the Key to Overseas Growth}, \textit{Sydney Morning Herald}, June 10, 1997, at 27.


\textsuperscript{14} See Fiona Kennedy, \textit{Ansett Cuts Jobs, Flights}, \textit{Australian}, May 6, 1998, at 5. Ansett began a recovery program in October 1997 that resulted in $115 million in annual cost savings. The program included selling non-performing assets, including Hayman Island on Australia's Great Barrier Reef, and the Hamilton Island Airport, closing retail offices, and calling for voluntary redundancies among its 17,000 person staff. The program will take five years. In the third quarter of 1997, Ansett posted losses of $14 million, even though it is expected to post a full year operating profit of between $30 million-$40 million. This profit is well below the target set by its Managing Director Rod Eddington. In September 1998, negotiations began regarding enterprise agreements with trade unions acting for employees. A one percent pay increase would add between $10 million and $12 million to Ansett's wage bill. See Michael McGuire, \textit{Ansett Sticks to Recovery Program}, \textit{Australian}, July 8, 1998, at 25.
The weak link in the partnership is Ansett Airlines, which has experienced four years of consecutive losses despite a major cash injection of $180 million from Air NZ. Air NZ acquired fifty percent of Ansett Airlines through the purchase of Trans National Transport’s (TNT) half interest in the company. TNT is one of Australia’s major international airlines freight carrier.

The recent approval by the ACCC of this proposed alliance partnership, with the partner airlines all operating within the Star Alliance, has the potential to allow creation of the largest alliance in the Asia Pacific Region, with a combined fleet of 223 aircraft covering 200 cities and 47 countries. The arrangement does not preclude the partners from forming other alliances. SIA, for example, already has separate agreements with Swiss Air and Delta Airlines. The new agreement has considerable benefits for Ansett Airlines since SIA is seeking an equity holding in the airline, possibly purchasing some of the News Corporation stock. It now seems clear that SIA also wants board control of Ansett. Since its launch in May 1997, the Star Alliance has sought to balance the dual development of the global Star brand and its six individual members’ brands. Rupert Duchesne, Vice President of Air Canada, states that “passengers want access to a single global network with “as much seamlessness as possible, and worldwide status and recognition from all the partner airlines. The best way to achieve this is with an overarching brand.” He also observes that as a result of such recognition, partners are now sharing terminals and merging key ticket offices, with Star alliance signage at thirty-five alliance airports worldwide. The objective is that within three years Star will be the lead brand in third country markets with the goal of

15 See Hosking, supra note 8, at 97; see also Gilchrist, supra note 8, at 4; Nic Hopkins, Ansett Trio Lift Sights, Australian Sept. 5, 1998, at 54.


17 See Hosking, supra note 8, at 97; see also Gilchrist, supra note 8, at 4; Hopkins, supra note 15, at 54.

18 See Hosking, supra note 8, at 97; see also Morrison, supra note 16, at 27. On Sept. 4, 1998, the airline reported a net profit of $30 million for the year ending June 1998. See id.; see also Morrison, supra note 8, at 25; Ionides, supra note 16, at 26; Geoffrey Thomas, Singapore Airlines Shows Star Quality, Sydney Morning Herald, Apr. 12, 1999, at 35.

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completing the global network with check-ins from any airport in the world.²⁰

V. THE PROPOSED AMERICAN AIRLINES (AA)-BRITISH AIRWAYS (BA) ALLIANCE

In 1992, American Airlines was the largest airline in the world. Since that time it has lost market share to United Airlines. The International Air Transport Association (IATA) stated in 1994 that American Airlines had 672 aircraft, its nearest rival United Airlines had 536, Delta 551, and British Airways 229.²¹ Recent figures indicate, however, that United Airlines ranks ahead of American Airlines on a range of accepted critical measures.²² If American wishes to become a truly global airline it must seek additional partnerships. As stated earlier in this article, the proposed alliance between British Airways and American Airlines still awaits the decision of the UK Monopolies Commission, as well as the British and US governments, on the conditions under which the Bilateral Agreement offering Open Skies will operate.²³

The BA-AA partnership has the potential to not only rival the Star Alliance but to exceed it in terms of size, revenue and total employees.²⁴ Currently its revenues are $45 billion.²⁵ In addition to the European Union Commissioner ordering BA and American to relinquish the 267 weekly slots at London’s Heathrow, the Commissioner has indicated that he will not approve the United-Lufthansa arrangements without similar concessions.

In a recent address, Commissioner Van Miert stated that the Star Alliance was in no way comparable to the BA-AA pact. He reaffirmed that, “the U.S.—Germany air market is the most competitive in Europe. [Lufthansa] is in direct competition with 11 carriers at [its] Frankfurt hub and 50% of German North Atlantic passengers are using competing non-German

²⁰ See Gallacher, supra note 19, at 58.
²⁴ See Welsh & Whitaker, supra note 10, at 31.
²⁵ See id.
Importantly, the group received a major victory in the auction for Aerolineas Argentinas that aided the possible establishment of a tripartite alliance between American Airlines, British Airways and Iberia Airlines. This arrangement was consolidated when Iberia joined oneworld two weeks after the official launch of the new alliance. The invitation followed the agreement of Iberia's terms of sale by Spanish stake holding company SEPI, under which American Airlines and British Airways will take 1% and 9% stakes respectively. Meanwhile, American Airlines is still awaiting approval for its proposed links with Aerolineas, Avianca and TAM. The five airline Taca Group is not included in this analysis, however, because the Group does not publish revenue numbers, although the revenues are estimated at approximately $400 million. But the Taca Group should not be overlooked because they are trying to complete a code-share agreement with American Airlines for service into Argentina. That agreement would further strengthen American's strategy of creating a viable global alliance.

VI. BACKGROUND TO THE ALLIANCES IN 1996-1999

American Airlines represents a powerful ally for British Airways. American's parent company, AMR Corp., was ranked first in airline operating profits in 1996 with $1.8 billion. The airline also demonstrated the best improvements in net results with $854 million, and the highest overall net profits of $1.0 billion. Three other carriers, United Airlines, British Airways, and Northwest Airlines also achieved operating profits in excess of $1 billion. Overall three-quarters of the top 100 major airlines earned net profits. The highest revenues were achieved by

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26 Taverna, supra note 4, at 36-37. This view may change given the recent appointment of former Labor Party leader Neil Kinnock as the new European Union (EU) Transport Commissioner.
27 See Welsh & Whitaker, supra note 10, at 31.
29 See id.
30 See Welsh & Whitaker, supra note 10, at 31.
31 It should be noted that Peru signed an Open Skies agreement on May 9, 1998 with Air France and Japan to be phased in over four years starting on June 12, 1998, surpassing Chile in its negotiations with cargo operations and seventh freedom rights fully liberalised by June 1999. See Karen Walker, Peru Open Skies First, AIRLINE Bus., June 1998, at 8.
American Airlines with $17.8 billion. Overall traffic for the year, however, reflected United Airlines leadership with 23.5 billion tonne km. United also achieved the largest margin against other major carriers in passenger km’s with 221.9 billion.\textsuperscript{35}

Between October 9 and October 15 of 1997, stock of UAL Corp, the parent company to United Airlines, gained 5 7/16, reaching 99 13/16 in heavy trading.\textsuperscript{34} This result indicates the strength of the stock as well as United’s solid financial base. Yet there are international carriers performing poorly. Twenty-seven of the major airlines together lost over $3.5 billion. These airlines include Alitalia, Swissair, TWA, Sabena, Korean Air, and Japan Airlines.\textsuperscript{35}

\section{VII. CONTINENTAL AIRLINES, DELTA AIRLINES AND AIR FRANCE}

The Continental Airlines - Alitalia Airlines link continues to expand, yet its codeshare arrangement with Air France faces formidable obstacles. Recently the French government agreed on a twenty percent privatization of Air France.\textsuperscript{36} In a partial privatization, seventeen percent of the airline will be sold to the public with three percent reserved for employees. A further ten percent will be offered to pilots and managers in exchange for wage concessions in order to lower costs. The partial sale will be lucrative since the airline is valued at between Ffr. 20 billion and Ffr. 27.4 billion making a twenty percent sale worth Ffr. 5.5 billion.\textsuperscript{37}

To this extent, Alitalia and Iberia have recently ended discussions on forming an alliance, with Air France pursuing an interest in Continental Airlines. Continental Airlines would in turn act as a beneficial partner for Air France and its associates. Continental Airlines has seen its profits rise with earnings up thirteen percent in the third quarter of 1996, the best results the airline has recorded. In 1996, the airline earned $110 million.

\begin{itemize}
\item \textsuperscript{35} See id.
\item \textsuperscript{34} See Anthony L. Velocci, Jr., \textit{Market Focus}, \textit{Aviation Wk. & Space Tech.}, Oct. 20, 1997, at 11.
\item \textsuperscript{35} See Welsh & Whitaker, \textit{supra} note 32, at 29.
\item \textsuperscript{36} See Bloomberg, AFP, \textit{One-Fifth of Air France up for Sale}, \textit{Weekend Australian}, Feb. 25, 1998, at 30; see also Tom Gill, \textit{Air France Faces Domestic Challenge}, \textit{Airline Bus.}, Nov. 1998, at 22.
\item \textsuperscript{37} See Bloomberg, AFP, \textit{supra} note 36, at 30. Air France’s performance in the six months prior to September 1997 showed a net profit of Ffr. 1.7 billion an increase from Ffr. 597 million in the same period a year earlier. See id.
\end{itemize}
compared with $18 million in the same period in 1995. The company has been one of the fastest growing airlines among major carriers, increasing its capacity 9.7 percent, primarily through new international routes. It is currently the sixth largest carrier in the United States. In December 1996, Continental Airlines and Delta Airlines held discussions concerning a merger. By June 1998, Air France and Delta Airlines had begun codesharing arrangements between Paris/Charles de Gaulle and New York / John F. Kennedy, as well as U.S. other cities. Since Delta Airlines is the third largest carrier and Continental Airlines the fifth largest carrier in the United States, together they would create the world’s largest airline. At present, the two airlines carry almost one quarter of all passengers flying on U.S. airlines. United Airlines, currently the world’s largest airline, carries twenty-one percent of all industry traffic with revenues in 1997 of $17.8 billion against its nearest rival American Airlines at $16 billion.

VIII. ALLIANCES IN CHINA: THE NEW FRONTIER

China is one of the fastest areas of growth in world air transport. Its largest regional carrier, Xiamen Airlines, has formed links with BA, Lufthansa, Qantas, SIA, Cathay Pacific, and Japan Airlines. Cathay Pacific is assisting Xiamen Airlines in developing the Xiamen Airport, 500 miles south of Shanghai, while BA has created a joint venture with China Southern Airlines based in Guangzhou. At the same time, China Eastern Airlines is seeking to acquire an equity holding in China Southern. Lufthansa Airlines has entered a joint venture with Air China in Beijing, while Qantas is negotiating with other airlines in Shenzen, Shanghai, and Yunan. Similarly, Ansett Airlines is seeking links with Air China to ensure an Asian presence following the


39 See id.

40 See id.


43 See id.
withdrawal of many of its regional services due to the Asian economic crisis.\footnote{44}

Since the recent open skies bilateral agreement between the United States and Taipei, American Airlines and Continental Airlines have increased their exposure in China.\footnote{45} The 1998 agreements provide a codeshare with EVA Airways, frequent flyer programs on trans-Pacific and domestic US services, as well as routes from Taiwan to South East Asia. Both American Airlines and Continental Airlines plan to use Taipai as a hub for such flights. These arrangements follow the US government’s approval of agreements between American Airlines and China Airlines.\footnote{46} But based on a competitive analysis of the Asia-Pacific aviation market, it appears that Continental Airlines and Delta Airlines are at a disadvantage, since United Airlines and North-West Airlines enjoy fifth freedom rights beyond Japan.\footnote{47}

Cathay Pacific Airlines, which was previously unaligned, recently announced a commercial relationship with oneworld.\footnote{48} The inclusion of Cathay Pacific is of crucial strategic importance. With Thai International Airlines and Singapore Airlines in the Star Alliance there were few choices remaining. One attraction of this relationship is the ability to connect traffic through Hong Kong’s new airport, Chek Lap Kok, as a regional hub. Providing connections for European flights to South East Asia and Australia was also significant and motive will satisfy investors. At the same time, since Cathay Pacific provides a major gateway to the rest of China with its Dragonair affiliates, and

\footnote{44} See Michael Sharp, Asia the Key to Overseas Growth, SYDNEY MORNING HERALD, Jun. 10, 1997, at 27; see also Kevin Morrison, Ansett Looks to Air China for Asian Links, SYDNEY MORNING HERALD, Oct. 6, 1998, at 29.


\footnote{46} See id.

\footnote{47} See id.

\footnote{48} See Michael McGuire, Star Pulls Ansett, Air NZ Into its Orbit, WEEKEND AUSTRALIAN, May 16-17, 1998, at 58; see also Kevin Morrison, Ansett Flying Too Low to Meet Profit Target, SYDNEY MORNING HERALD, July 30, 1998, at 23. Ansett has undertaken a major strategic review and is aware that it now holds only about forty-seven percent of the domestic market, down from fifty-five percent six years ago. See id. Ansett reported an operating profit of (Aust) $28 million in 1997-1998 representing 0.8 percent of the airlines turnover of (Aust) $3.7 billion. See Karen Morrison, Ansett Prepares to Fly High, SYDNEY MORNING HERALD, Sept. 17, 1998, at 33; WAN, Cathay Loss, SYDNEY MORNING HERALD, Aug. 7, 1998, at 26. In 1998, Cathay Pacific posted its first loss in 22 years as a public company. It recorded a net operating loss of $175 million for the six months prior to June 30, 1988, compared with a $1.06 billion profit for the same period last year. See id.
China Eastern Airlines a potential new partner, it has the opportunity of opening up a major route to China’s domestic market.49

IX. ONEWORLD ALLIANCE GROUP

In November 1998, after two years of joint operations, British Airways signed its pact with American Airlines and announced at the same time the establishment of the oneworld Alliance. The partners include Canadian Airlines, Qantas Airways, and Cathay Pacific.50 A frequent flyer program began in February 1999. The decision by the oneworld group was timely, given that the partners in the Star Alliance had been operating successfully for two years prior to the oneworld announcement. In order to gain market share, the new alliance needs to reposition its strategy as a matter of urgency. As Gill observes, the oneworld alliance is a latent recognition that while rearming to fight the battle in the Atlantic, they were losing the global marketing war, with twenty-five percent of gold card club members preferring Star and a possible migration of their high yield business traffic to the Lufthansa Alliance Group.51

On March 1, 1999, Finnair joined the oneworld alliance along with its European partners, LOT and Malev, and Spain’s Iberia Airlines, in which BA intends to purchase a ten percent interest. BA’s equity interest in Iberia is tied to a “broad cooperation agreement” with the objective of saving Ptas 18 billion for the two companies through lower costs and revenue increases in the next three years.52

In contrast to the merger with BA, Iberia’s alliance with American Airlines, its joint ownership of Aerlinas Argentinas, and American Airlines’s one percent interest in Iberia, are set to remain within the framework of oneworld. The marketing agreement signed by the two carriers in May 1998 involves code

49 See McGuire, supra note 48, at 58.
50 See Gill, supra note 8, at 34-36; see also The Guardian, London, BA Puts AA Link on Hold, SYDNEY MORNING HERALD, Nov. 2, 1998, at 44. The most recent announcement by BA is that the alliance will now be put on hold and phased in over a period of four to five years due to the failure of the British and American authorities to reach an “open skies” agreement. In addition, BA believed it made more sense to phase in any agreement between US and British authorities to remove the flight restrictions at Heathrow once the airport’s infrastructure can support more airlines. See id.
51 See Gill, supra note 8, at 34-35.
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sharing between Spain and twenty-two destinations in the U.S.A., linked frequent flyer programs and cooperation in cargo, increasing the carrier’s revenues by thirty percent on the jointly operated routes. This suggests that the two alliances are closely matched.

Based on 1997 statistical data, oneworld has a market share of 64.5 percent of international passengers, while the Star Alliance held 65.6 percent. In market share, oneworld held fifteen percent, with the Star Alliance holding fifteen percent. On potential world share, however, oneworld is forecast to have twenty-one percent of the market with the Star Alliance holding twenty percent.

X. CONCLUSION

Global alliances are about international airlines reaping economies of scope by extending their marketing networks through a range of measures based upon code sharing, franchising, block spacing, and equity holdings. The strategy aims at forming alliances with airlines possessing compatible corporate cultures and sharing a common vision to strive for global goals. The new aviation markets include South America, with Varig Airlines seeking to exercise a dominant role, and China, where Cathay Pacific and China Eastern Airlines dominate. Yet the future remains uncertain in the new millennium. What is clear, however, is that the dominant carriers, United Airlines, American Airlines, Delta, Continental, Lufthansa, and Singapore Airlines will continue to assert themselves on a global scale and the smaller carriers will seek alliances with one or more of the major groups or risk ultimate demise.

53 See id.
54 See Gill, supra note 8 at 36.
55 See id.
56 See id. at 34-36.
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