

Chapter 14

International Alliances

International alliances using cooperative relationships come in all shapes and sizes often under the rubric of strategic alliances. In this Chapter the types of international alliances, the motives and the logic behind such alliances are discussed.

Basic Types of International Alliances

In general, *strategic alliances* or *strategic partnerships* can be defined as “a coalition of two or more organizations to achieve strategically significant goals that are mutually beneficial” (Kotabe/Helsen 2008, p. 305). International alliances or *cross-border alliances* are partnerships of organisations/companies from different countries. By setting up a partnership the companies strive for a *joint competitive advantage*. This joint competitive advantage is based on joining strengths or compensating weaknesses (see Figure 14.1). From the point of view of *new institutional economics*, strategic alliances are positioned between the transactional options market and integration/hierarchy (see Chapter 12 and Chapter 13), or on a scale between externalisation and internalisation.

Joint Competitive Advantage

Strategic Advantages of Alliances

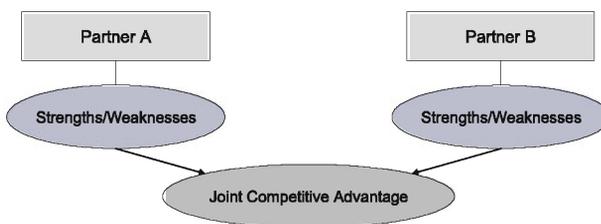


Figure 14.1

Strategic alliances lead to a new economic phenomenon: *co-opetition*. Cooperation and competition are no longer considered to be direct opposites. Rivalry, a basic feature of dynamic competition, is considered to be compatible with cooperation in order to achieve a common aim. This tendency also leads to a new perspective or even a new *paradigm* in competition theory and competition strategy. From the perspective of legislation, strategic alliances

are not only being more tolerated than before but are even actively being encouraged. However, any cooperation that could lead to *collusion*, such as price fixing, is still considered to be a highly sensitive subject.

Critical Mass Alliances and Closing Gap Alliances

Y-Alliances

Critical mass alliances or *Y-Alliances* (Porter/Fuller 1986) achieve a joint competitive advantage by compensating individual weaknesses. The critical mass can be achieved, for example, by bundling the purchasing volume of the partners in a *buying group* or by joint R&D in creating an important innovation, such as in the field of semi-conductors or biotechnology or gene technology. The logic of this type of alliance centres around *economies of scale*.

X-Alliances

Closing gap alliances or *X-Alliances* (Porter/Fuller 1986) are based on combining complementary strengths. They are based on the mutual access to resources and potentials, such as local resources and capital, know-how, technologies, image, etc. To enter a foreign market by establishing a firm (equity joint venture) together with a domestic partner in the target country can be used as an example. The domestic partner knows the local market and has access to distribution channels, while the “entering” partner has, for example, a strong brand and marketing know-how.

Non-contractual Alliances, Contractual Alliances and Equity Alliances

A further distinction involves the formal structure of *cooperative arrangements*:

- non-contractual alliances
- contractual alliances
- equity alliances.

Non-contractual Alliances

Non-contractual alliances are usually formed *ad hoc*, even if they are planned to continue in the long term. This informal cooperative relationship is used, for example, in joint buying activities, such as in electronic *reverse auctions* on internet platforms (see e.g. Zentes/Morschett/Schramm-Klein 2007, p. 261).

Contractual Alliances

There are numerous forms of contractual alliances, also labeled as *contractual joint ventures*. The most well known, described in this Chapter, are:

- licensing
- franchising
- management contracting.

Equity alliances are characterised by the capital investment made by the alliance partners or parental partners. This can be structured in a number of ways. The first is a form of *cross shareholding*, an instrument which is predominantly chosen to stabilise an alliance. In *equity joint ventures* the alliance is institutionalised in a new legally independent unit, in which the alliance partners hold an interest, jointly assuming the risk as well as the responsibility for the management. Equity joint ventures are not necessarily characterised by *equal ownership* (50-50 ownerships). Equity joint ventures will also be described in this Chapter.

Comprehensive and Functional Alliances

According to the *scope* of strategic alliances comprehensive alliances and functional alliances can be distinguished. Functional alliances are narrow in scope: Only a single function of the business area is involved. This type includes procurement alliances, R&D alliances, production alliances, marketing alliances or financial alliances.

Comprehensive alliances are characterised by a high degree of collaboration. The participating firms perform together all or at least the main activities of the value chain. The alliance "*oneworld*", described as case study in this Chapter, is an example of this type.

Selected Forms of International Alliances

International Licensing

In licensing agreements the *licensor* grants the rights to intellectual property to the *licensee* for a defined period, which pays *royalty fees* in return. The nature of licensing agreements varies depending on the activity of the value chain, e.g. production or distribution/marketing (see e.g. Burr 2005; Hill 2008, pp. 407-408) (see Figure 14.2).

Types of License Agreements

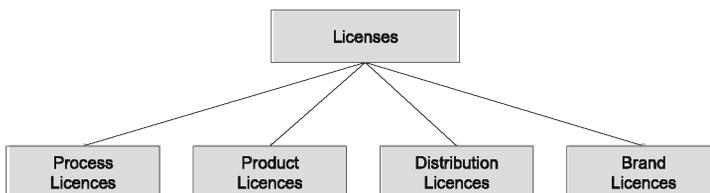


Figure 14.2

**Contract
Manufacturing**

In *process licences* the licensor grants the licensee the right to use a specific production technology, often based on a patent, , e.g. in the chemical or pharmaceutical industry. In the case of a *product licence*, the licensor grants the right to manufacture a product or certain products in accordance with specific procedures, processes or formulas. *Contract manufacturing*, a contractual agreement between a company and a foreign producer under which the foreign producer manufactures the company's product (see e.g. Morschett 2005; Phatak/Bhagat/Kashlak 2009, p. 210), is often combined with this type of licensing. In this case the licensee is producing on behalf of the licensor and selling the products to him; the licensee has no *distribution licence*.

If a *distribution licence* has been granted, the licensee has the right to market the products in a specific territory. In the case of a "simple" distribution licence or a "pure" distribution licence, the licensor remains the manufacturer and therefore the supplier. These kinds of licensing represent a *foreign entry choice*.

Brand Licences

Brand licences are very important with regard to marketing as they entitle a licensee to use a brand name. A specific shaping of brand licensing is to grant a licensee the right to use a *trademark* for products other than those the licensor is producing. An example of this kind of licensing intellectual property rights is the *American Coty Group*, which sells world-famous perfume brands like *Calvin Klein*, *Cerruti*, *Vera Wang*, *Chloé* and *Lagerfeld* on the basis of brand licences. *Coty* bought the division of luxury perfumes from the Dutch-British *Unilever Group*.

Advantages and disadvantages of licensing in international markets are listed in Table 14.1.

Table 14.1

Advantages and Disadvantages of Licensing

Advantages	Disadvantages
<ul style="list-style-type: none"> ♦ access to difficult markets ♦ low capital risk and low commitment of resources ♦ information on product performance and competitor activities in different markets at little cost ♦ improved delivery and service levels in local markets 	<ul style="list-style-type: none"> ♦ disclosure of accumulated competitive knowledge and experience ♦ creates possible future competitors ♦ lack of control over licensee operations ♦ passive interaction with the market ♦ exclusion of some export markets ♦ organising licensing operations: cost of adaptation, transfer and controlling

Source: Bradley 2005, p. 244.

International Franchising

Franchising is defined as a contractual agreement between two legally and financially separate companies, the franchisor and the franchisee. By franchise agreements the *franchisor* not only grants intangible properties, e.g. a trademark, to the *franchisee*, but it also includes counselling and help in the management of their business. In addition, the franchisees can profit from the experience of all other franchise partners. (see e.g. Zentes/Morschett/Schramm-Klein 2007, pp. 82-84).

With regard to international franchising, different options exist (see Zentes/Swoboda/Schramm-Klein 2010, pp. 236-238) (see Figure 14.3). In *direct foreign franchising* the franchisor signs individual contracts with partners in the different countries. In the case of *master franchising* the franchisor signs a *single contract* with the *master* or *general franchisee* in a country-market or in a region, who is allowed to grant franchises (sub-franchise relationships) in that market.

An *indirect franchise structure* is characterised by a wholly-owned subsidiary or an equity joint venture created in a foreign country-market, which operates as a franchisor in this market. In this case, franchising is a mixture of a contractual alliance and an equity alliance or ownership strategy in the foreign market.

From the franchisor's perspective the advantages of franchising in international markets are (Bradley 2005, p. 247):

- rapid expansion over a wider area may be achieved relatively quickly
- low overhead costs
- avoidance of day-to-day business details
- uses the skills of people with local knowledge.

The disadvantages of franchising are from this perspective (Bradley 2005, p. 247):

- risk of lowering the quality of a brand name
- absence of direct control over a franchisee's operations
- passive interaction with the market.

Advantages from the franchisee's perspective are remaining entrepreneurial independence due to the relation based on *partnership*, the great variety of support activities and frequently the guarantee of "*territorial sovereignty*" with regard to the local market. Therefore, franchising is very attractive for SMEs.

*Franchise
Agreements*

*Direct
Franchising*

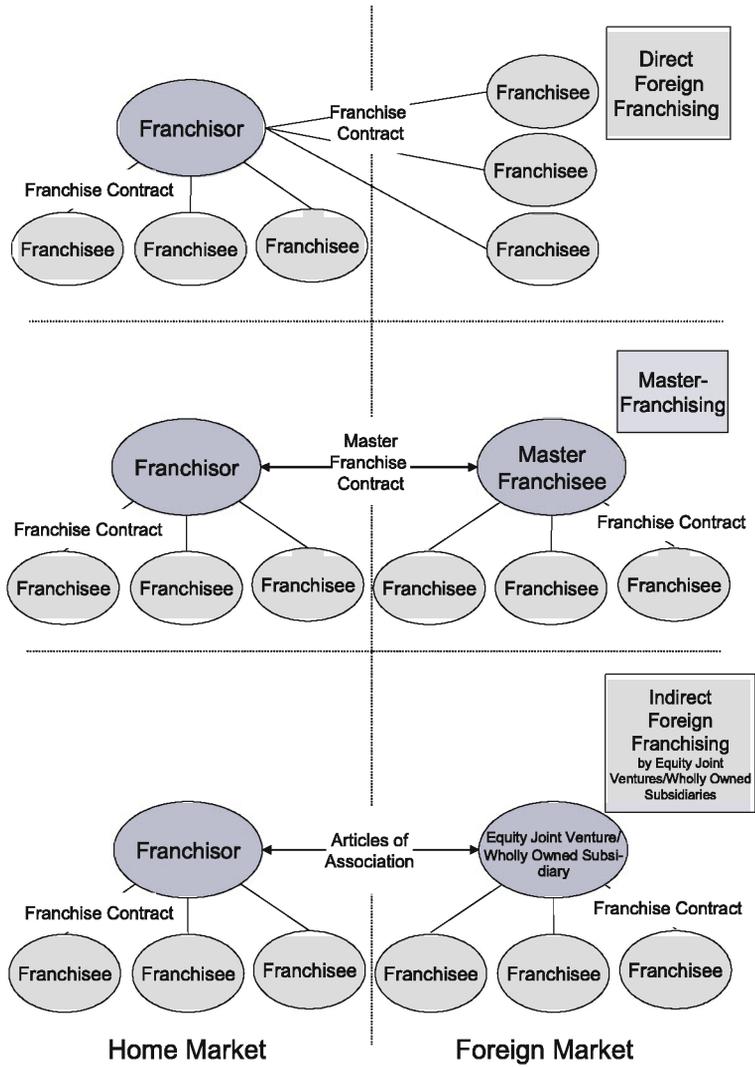
*Indirect
Franchising*

*Franchisor's
Perspective*

*Franchisee's
Perspective*

Figure 14.3

Types of International Franchise Agreements



Source: Adapted from Zentes/Swoboda/Schramm-Klein 2010, p. 237.

International Management Contracting

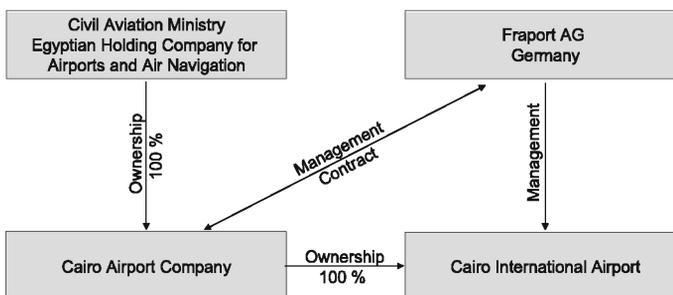
By international management contracts or *management service contracts* a company is allowed to be involved in the management of a firm in a foreign market of which the managing company has no shares (see e.g. Foscht/Podmenik 2005). By such agreements a firm provides managerial expertise and operates the daily business of the second firm for a specified period in return for monetary compensation. The managing firm gets a commission based on the revenues or profits of the managed firm and/or yearly (minimum) lump-sum payments.

In the case of international management contracts there is a clear distinction between the investors or shareholders and the company which is managing the operations, sometimes simultaneously training national managers until they are able to take over. Recent examples of management contracts can be found in industries like hotels (see the case study “Accor” in Chapter 12), hospitals, airports, seaports, and public utilities.

International management contracts are a way to attain know-how and/or experience in a new field (Macharzina/Wolf 2008, p. 969) from the point of view of the managed firm. For the managing firm, such a contract serves as a *source of income* on the one hand and as a possibility to scout a new market and to establish the company or its brand in this market on the other hand. This is the case, if the managed firms appear externally as part of the *global chain*, usually under an internationally recognised name.

Figure 14.4 illustrates the structure of the management contract system of the German Fraport AG managing the Cairo International Airport.

Structure of a Management Contract System in the Airport Industry



Source: Fraport AG.

*Management
Service
Contracts*

*Managed Firm's
and Managing
Firm's
Perspectives*

Figure 14.4

International Equity Joint Ventures

The reasons for establishing an equity joint venture with foreign partners, i.e., a firm that is jointly owned by two or more otherwise independent firms, are legislation or the need for the other partner's skills, competences or assets. Governments in some countries, mainly less developed countries, insist on joint ventures with local partners. This policy restricts the *ownership strategy alternatives*. The access to assets, such as capital, of the local partner is another reason for entering into an equity partnership (see, e.g., Voeth/Rabe 2005).

"The financial advantages of joint ventures may permit an international enterprise to enter into more foreign projects when its financial resources are limited. In some cases, local partners will accept the technological know-how, patent rights, or even the trade name of the international enterprise as a substitute for capital in payment for a share of the subsidiary's equity. Joint ventures also lessen the risk of foreign exchange losses by reducing the amount of investment at stake" (Robock/Simmonds 1989, p. 216). The main disadvantages of equity joint ventures are potential conflicts in managing the business and transaction costs in coordinating the foreign operations. This situation is typical for equal ownership in contrast to acquiring a majority stake. In summary, the advantages and disadvantages of international equity joint ventures are listed in Table 14.2.

Table 14.2

Advantages and Disadvantages of Equity Joint Ventures

Advantages	Disadvantages
<ul style="list-style-type: none"> ♦ reduced investment and reduced risk compared to a solo effort ♦ circumvention of local-content rules and other barriers ♦ access to regional resources ♦ circumvention of rules prohibiting the acquisition of existing companies or the establishment of a new firm in host countries ♦ establishment or modification of market barriers ♦ appearance as a local company ♦ use of aid programmes or subsidies in host countries 	<ul style="list-style-type: none"> ♦ high controlling costs ♦ conflicts with regard to marketing strategies or expenditure of profits ♦ cultural differences ♦ loss of influence ♦ slow adaptation of the joint venture to changes in the market, political and legal environment

Source: Adapted from Belew 2000, pp. 256-260; Scherm/Süß 2001, pp. 139-140.

Organisational Structure of Strategic Alliances

A fundamentally different distinction can be made as to how the strategic alliance is organised. Looking at *network management*, one can differentiate between the following organisational models (see Figure 14.5; see also Chapter 1):

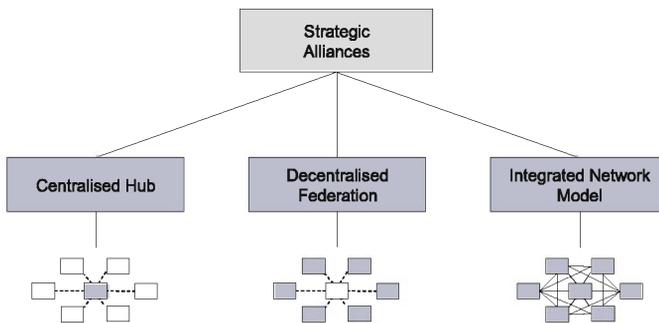
- centralised hub
- decentralised federation
- integrated network model.

The *centralised hub* is characterised by a star formation, with the centre as the hub. This is the case in traditional franchising systems: The franchisor operates as the centralised hub. The *federation* is characterised by a decentralised structure. The federation of largely independent players is coordinated by one organisational unit, which possesses only limited decision-making power. This is the case, for example, in buying and marketing alliances (functional alliances) of just a few, but very large retail companies. The *integrated network model* is characterised by a marked organisational and performance-oriented interdependence (see the case study in this Chapter).

*Network
Topology*

Organisational Modes of Alliances

Figure 14.5



Source: Adapted from Bartlett/Ghoshal/Beamish 2008, pp. 338, 342.

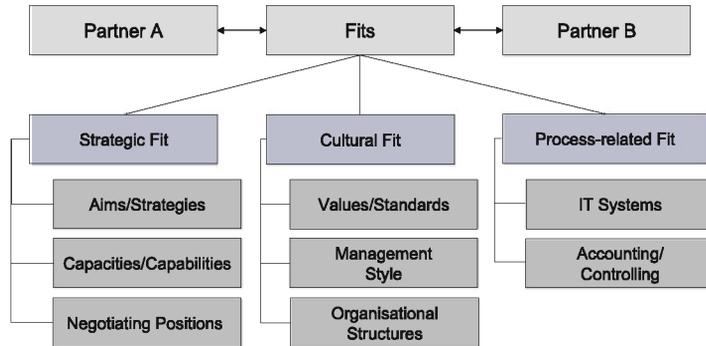
Stability of Strategic Alliances

The chances of the establishment of a strategic alliance and the stability of alliances are dependent to a great extent on the *fits* between the partners

Fits and Stability

(Zentes/Swoboda/Schramm-Klein 2010, pp. 242-243) (see Figure 14.6). These fits can also be used as *guidelines in assessing* potential partners.

Figure 14.6 Fits in Cooperative Agreements



Relational Risks

The *strategic fit* refers to the aims and strategies, capacities/capabilities and negotiating positions of the partners. For example, if a partner does not fully commit himself to the alliance, because the partners do not have similar strategic goals, this lack of commitment may affect the attainment of the objectives of the alliance. Another *relational risk* or reason for the failure of partnerships is cultural divergence. This means that the values and standards, the management styles and the organisational structures must be compatible (*cultural fit* or *cultural proximity*). The process/infrastructure fit (*process-related fit*) refers to correspondence, or at least compatibility, of the technical systems of the organisation, such as of the IT systems, of the accounting/controlling system, etc.

Conclusion and Outlook

Networks of Value Creation

In the national as well as the international context, *networks of value creation* emerge. They represent a new organisational model for complex processes of value creation. A broad and growing variety of forms can be distinguished. Important manifestations of alliances have been discussed in this Chapter.

Besides the multitude of variants that are frequently implemented in a combined manner in companies, another phenomenon can be seen: Strategic alliances are spread to all industries and even to other social sectors. As seen,

management contract systems, which are of great importance in the hotel industry, are transferred in a growing extent to other industries, such as airports, seaports and other infrastructure entities or public utilities.

Another example is *social franchising*. Social franchising can be defined as the “adapted usage of techniques from commercial franchising for projects which benefit the social aims of the non-profit sector” (German Foundation of World Population 2001, p. 3). The rise in the number of non-profit initiatives using franchising can be attributed “to the increased openness of the third sector to using commercial tools and to acting more entrepreneurially in order to become more effective” (Bundesverband Deutscher Stiftungen 2008, p. 25).

*Social
Franchising*

Further Reading

HAMEL, G.; DOZ, Y.; PRAHALAD, C. (2008): Collaborate with Your Competitors – and Win, in: BARTLETT, C.; GHOSHAL, S.; BEAMISH, P. (Eds.): *Transnational Management*, 5th ed., Boston, MA, McGraw-Hill; pp. 640-647.

OHMAE, K. (1993): The Global Logic and Strategic Alliances, in: *Harvard Business Review*, Vol. 67, No. 2, pp. 143-154.

SCHULER, R.S.; JACKSON, S.E. (2002): Strategic Human Resource Issues in International Joint Ventures, in: SCHOLZ, C.; ZENTES, J. (Eds.): *Strategic Management – A European Approach*, Wiesbaden, Gabler, pp. 243-262.

Case Study: oneworld¹

Profile, History, and Status Quo

oneworld, formed in 1999, is the world’s third largest airline alliance, after the *Lufthansa*-dominated *Star Alliance*, and *SkyTeam*, which is centred around *KLM* and *Delta Airlines*. In 2008, about eight million passengers were transferred between *oneworld* member flights, generating about 2,400 million USD in revenues for the member airlines. Of these revenues, 850 million USD were generated by alliance fares and sales (*oneworld* 2010). Almost two-thirds of the 850 million USD are classified as incremental by the alliance, i.e. revenues its members would not have earned if they were not members of

¹ Information used for this case study includes various annual reports, press releases, the web site <http://www.oneworld.com> as well as explicitly cited sources.

the alliance, thus proving the enormous importance of the membership for the individual carriers.

Formed in February 1999, almost two years after the world's first and largest airline alliance, the *Star Alliance*, the five founding members – *American Airlines*, *British Airways*, *Cathay Pacific*, *Canadian Airlines*, and *Qantas* – started offering *oneworld* services and benefits. Today, there are eleven member airlines as well as roughly 20 affiliated airlines which provide regional services in association with the alliance's members.

The *oneworld* alliance is sometimes described as “two clusters of airlines” (Kleymann/Seristö 2004, p. 24), with one centring around *American Airlines* and the other evolving around *British Airways*. Initially, a very close cooperation on the Northern Atlantic routes between these two carriers had been planned. However, opposition from regulatory authorities, fearing that a monopolistic situation in the large US-UK market might ensue, placed severe limitations on the degree to which the two airlines can cooperate. The latest recruitment of *oneworld* is *Mexicana*, the leading airline in Mexico and Central America, that joined in November 2009. Russia's leading domestic carrier *S7 Airlines* and Indian based *Kingfisher Airlines* are about to further strengthen the alliance in the near future.

oneworld enables its members to offer their customers more services and benefits than any single airline can provide on its own. These include a broader route network, opportunities to earn and redeem frequent flyer miles and points across the combined *oneworld* network and more airport lounges. It is the only airline alliance whose members collectively achieved a profit in their latest full financial years.

In November 2009, *oneworld* was named the world's leading airline alliance for the seventh year running in the *World Travel Awards*, the travel industry's equivalent to the *Academy Awards*. The *World Travel Awards* are based on votes cast by roughly 170,000 travel professionals and agents in 200 countries. *oneworld* has retained the award for leading airline alliance every year since this category was introduced in 2003.

oneworld's Vision

The alliance's vision is to “generate more value for customers, shareholders and employees than any airline can achieve by itself”. A specific set of guidelines has been set up by *oneworld* in order to achieve and fulfil this specific vision:

- making travelling smoother and easier and creating better value for customers
- going beyond and offering customers travel solutions that other individual airline networks cannot match

- establishing a mutual commitment that will reassure that high quality standards, service and safety are attained
- making customers feel comfortable while travelling, by creating a home-like environment
- delivering savings and benefits greater than non-allied airline carriers.

The Global Airline Industry

The global airline industry is regarded as being different to other industries in many ways. Over the course of the twentieth century, the airline industry has developed into one of the world's largest industries. While the airline industry in the broader sense consists of two segments, the passenger and the cargo segment, the focus of this case study is solely on passenger transportation. Since the start of commercial aviation, airlines have been a symbol of national pride for countries all over the world, as the fact of having a so-called "flag carrier" which travelled the globe in order to transport its citizens to new countries as well as to bring foreigners into the home country, was seen as a sign of power and economic prosperity. Thus, government-owned or government-controlled corporations usually operated these national carriers.

As a result, the airline industry has traditionally been heavily regulated and government controlled since its beginnings at the start of the twentieth century. In Europe, the governance has been especially evident as the political agenda of the governments controlling or partially owning the airlines has affected the profitability of the industry (Vaara/Kleymann/Seristö 2004). In 1978, the US air traffic was deregulated and liberalised. In Europe, the European Union was the force that deregulated the airline industry in 1993 through the so-called third air traffic package, which aimed to create a market with free competition, free market entry and free pricing. The free market entry together with free pricing meant that the airlines only had themselves to answer to for making their companies profitable (Gustaffson 2005). These new terms of competition were very different and the companies that earlier had strategies focusing on building up national infrastructure and safety had to compete on the same terms as other industries. When the airline business was liberalised in the European Union, no-frills carriers *Ryanair* and *easyJet* quickly became the pioneers for low-cost operations in Europe. They adapted the same system that was already used in the American market by such budget airlines as *Southwest* and *ValuJet*. The business model of these low-cost or no-frills carriers basically consists in offering low travelling fares in exchange for eliminating many passenger services, based on the lowest possible costs.

Deregulation and Liberalisation in the USA and Europe

Rise of No-frills Carriers

Possible Outcome of Greater Liberalisation

Air transport is governed by a 60-year-old system of bilateral air services agreements that limit access to markets and constrain consolidation. Governments determine markets instead of permitting passenger demand to do so, and airlines are not allowed the basic commercial freedoms that other businesses enjoy. It is estimated by many that greater liberalisation would improve industry profitability and bring significant social and economic benefits. For example, in 2006, liberalisation between India and the United Kingdom resulted in weekly flights doubling to 200. All airlines in that market today share the benefits of the newly created opportunities while customers benefit from increased competition and greater choice of flights. The International Air Transport Association (IATA) estimates that the full liberalisation of the airline industry by Chile, Singapore, and the United Arab Emirates (UAE) would result in the addition of approximately 20 million passengers, 200,000 jobs, and 3,600 million USD in GDP growth (IATA 2010, p. 24).

Effects of 9/11 and Rising Oil Prices

Over the last ten years, the industry has changed significantly and beyond the cyclical nature of the air transportation business. Not only did the tragic events of 11 September 2001 result in immediate layoffs and cutbacks of roughly 20 % in total system capacity, but the entire industry is suffering an economic crisis for a number of reasons. Over the past 25 years, for example, the industry has witnessed a reduction of more than 50 % in ticket prices while, at the same time, the airlines' labour costs and fuel prices have increased as kerosene prices, driven by the crude oil costs, have climbed to unseen heights. Today, the airline industry is one of the most competitive industries worldwide. In its long history, the industry has shown proof of the importance of collaboration with different competitors to remain competitive – or simply to avoid elimination (Holmgren/Platt/Svennerholm 2008, p. 9).

Airline Alliances and Networks

History of Airline Alliances

There is a long tradition of cooperation in the airline business. Despite some dispute in the relevant literature, most authors agree that the first step towards alliance in the airline business dates back to the 1930s when *Pan-Am* purchased *Peruvian Airlines* in order to expand its services into Latin America. Ever since the 1960s, airlines have cooperated in order to overcome capital-driven growth obstacles and to realise operative synergies. Another big milestone in terms of airline alliances was reached in 1992 when *Northwest Airlines* and *KLM* jointly launched the world's first open-skies agreement between the USA and the Netherlands. During the 1990s, a number of external factors pressured the airline industry to develop better solutions in order to meet higher demands and expenses, especially from business travellers.

The increased availability and usage of the internet as well as the strong trend towards globalisation also had a large impact on the overall airline industry environment. Under these circumstances, *Air Canada*, *Lufthansa*, *SAS*, *Thai Airways* and *United Airlines* joined forces and created the *Star Alliance* in 1997, which was a revolutionary change for the entire industry. Overall, it can be observed that while cooperation is by no means a new phenomenon, it has in the more recent past changed its focus from being mostly technically oriented (e.g. with maintenance pools between individual airlines) to customer-oriented marketing activities (Kleymann 1999, p. 131).

Four main reasons and strategic factors can be cited which drive alliance formation:

- Need to *gain entry to international markets* which are restricted by bilateral agreements: an alliance allows carriers to serve international markets without actually obtaining the right to do so through country-negotiated bilateral agreements. Accordingly, global airline service networks are likely to be formed by alliance groups of airlines residing in different continents in order to benefit most from the enlarged route network served by becoming an alliance member.
- Wish to *build a global seamless network*: customers prefer airlines with a larger network since they can minimise their travel time, increase the number of online connections, and participate in better frequent flyer programmes.
- *Cost reduction*: joint activities, e.g. in parts pooling or ground handling, help reduce costs or create economies of scale.
- Desire to *maintain market presence* in areas where the specific characteristics and growth potential renders single activities unprofitable (Gudmundsson/Rhoades 2001, p. 210).

Today the economic importance of the alliances is enormous. Members of the three major airline alliances account for roughly 76 % of the global revenue passenger kilometres (RPK), a measure of the volume of passengers carried by an airline. A revenue-passenger kilometre is flown when a revenue passenger is carried one kilometre: revenue passengers include all passengers for whose transportation an airline receives commercial remuneration, i.e., excluding babies and children, as well as passengers travelling under fares available only to airline employees. All 15 of the world's biggest airlines are members of one of the three alliances, proof of the importance of these alliances. Table 14.3 compares the three largest alliances on the basis of some key indicators: *Star Alliance* clearly leads the field by a distinct span, followed by *SkyTeam* and *oneworld*.

Driving Forces for Alliance Formation

Importance of Airline Alliances

Table 14.3

Overview of Three Major Airline Alliances 2010

Characteristics	Star Alliance 	SkyTeam 	oneworld 
Number of Member Airlines	27	9	11
Most Important Members	Lufthansa, Air Canada United, ANA, US Airways, Continental, Air China, Singapore Airlines	Air France, Delta, KLM, Alitalia, Korean Air	British Airways, American Airlines, Iberia, Qantas, Finnair
Founded	1997	2000	1999
Number of Passengers per Year	624 Mio.	384 Mio.	328 Mio.
Daily Departures	21,050	13,133	8,387
Countries Served	181	189	142
Destinations	1,167	856	727
Employees	404,000	318,445	285,164
Fleet	4,022	1,941	2,280

Source: www.staralliance.com; www.skyteam.com; www.oneworld.com.

Since airlines have traditionally, generated poor financial performance, not least due to government protection and ownership, it has been said that the airline business is not cyclical business, but bad business altogether. In the long run, an average airline loses money. Between 1982 and 2002, airlines belonging to the IATA organisation, representing some 230 airlines and carrying over 90 % of worldwide passenger traffic, generated revenues of two trillion USD and cumulative losses of five billion USD. As a result, airline alliances can also be seen as a response to the risks and uncertainty associated with industry turbulence. That is to say, airline alliances are seen as a means of improving financial performance in times of stiff and hardening competition. Given the downfall in air travel after 11 September 2001, the deregulation of many markets in Asia, Europe and North America, as well as the rapid rise of low-cost carriers, membership in an airline alliance has come to be regarded as a necessity for most well-established airlines (He/Balmer 2006, p. 243).

Strategic Benefits of Alliance Membership

One of the main strategic objectives in joining an airline alliance is achieving cost advantages. Contrary to the manufacturing industry, where cost advantages can be generated via economies of scale, cost potential in the case of the airline industry can be reaped from alliancing in terms of synergies, e.g. through joint fuel procurement or facility sharing. Airline alliances belong to the type of Y-Alliances, or critical mass alliances, where the corporations

engage in similar activities and are therefore potential rivals, as opposed to vertical relationships, or X-Alliances, among complementary buyers and suppliers.

Thus, *oneworld* members experience a typical situation of cooperation within their alliance. On the one hand, they profit from the alliance's advantageous terms with regard to the purchase of aircraft and fuel. On the other hand, they operate in the same business segment of air travel and are therefore rivals. However, compared to the bigger *Star Alliance* and *SkyTeam* (see Table 14.3), *oneworld* is characterised by a limited number of routes operating in direct competition by all its carriers which has led to a comparatively mild increase in competition (Commerce Germany 2005, p. 10).

Table 14.4 shows the different possible types of joint activities for members of airline alliances. The most common types of activities include code sharing, blockspace and/or feeding agreements, whereas adoption of IT reservation systems and management contracts are used rather infrequently (Gudmundsson/Rhoades 2001, p. 210).

Types of Joint Activities of Airline Alliances

Table 14.4

Type of Activity	Description
Codeshare	one carrier offers service under another carriers' flight designator
Blockspace	one carrier allocates seats on its flights to another carrier to sell
Revenue Sharing	two or more carriers share revenues generated by joint activity
Wet Lease	one carrier rents the aircraft/personnel of another
Computer Reservation System	one carrier shares and/or adopts the internal reservation system of another
Insurance/Parts Pooling	two or more carriers agree to joint purchase
Management Contract	two or more carriers offer combined flight service
Baggage Handling/Maintenance/Facilities Sharing	one carrier contracts with another to provide services/personnel/facilities at specified sites
Franchising	one carrier "rents" the brand name of another for the purpose of offering flight service but supplies its own aircraft/staff
Joint Marketing/Common Branding	two or more carriers combine efforts to market joint services/activities
Equity Swap/Governance	two or more carriers swap stock and/or create joint governance structures

Source: Gudmundsson/Rhoades 2001, p. 210.

When *oneworld* was founded, one of the main aims was to profit from different geographical areas in order to better serve the customer. The members wanted to expand and strengthen their international presence in ways that

oneworld Membership Market Advantages

would be impossible without an alliance. Each company thus compensates for the other's weaknesses in a given territory with the strength of its partners (Czipura/Jolly 2007, p. 61). Apart from this foremost important benefit of expanding seamless service networks, a number of other benefits were realised when the *oneworld* alliance was formed: Service quality could be improved due to an increased flight frequency, more convenient flight schedules and an augmented number of on-line connections could be offered. Also, waiting time for passengers on connecting flights could be minimised due to the higher number of flights offered (Oum/Park/Zhang 2000, p. 14).

Cost Advantages

As for cost sharing ventures, *oneworld* members could realise cost advantages from jointly purchasing equipment and fuel, leading to bulk discounts. Also, the airlines started operating joint transfer centres and help desks as well as maintenance centres which also helped cut costs (Commerce Germany 2005, p. 8).

Marketing Benefits

There are also a number of possible marketing advantages to be gained from membership in an alliance, such as enlarged frequent flyer programmes, where alliance partners cooperate to allow passengers to accrue miles on their home carrier's programmes even though they use a partner's flight and also permit them to use rewards on each other's flights. Although the *oneworld* alliance does not offer its own frequent flyer programme, customers who are members of schemes such as *American Airlines AAdvantage Program*, *British Airways Executive Club*, *Cathay Pacific Marco Polo Club*, *Finnair Plus*, *JAL Mileage Bank*, *Iberia Plus*, *LANPASS*, *Malév Duna Club*, *MexicanaGO*, *Qantas Frequent Flyer* or *Royal Jordanian Royal Plus*, can obtain their miles, rewards and privileges throughout the entire alliance.

Another marketing advantage stems from the multiple display of the same flight on computer reservation systems (CRS) in travel agencies or online booking tools: a codeshared flight is listed twice on the CRS screen since both partners list the same flight as their own. This leads to augmented display of the same offer, increasing the possibility of the flight being booked. In addition to these cost and marketing advantages, benefits result from increased market share and market power, which is why airline alliances such as *oneworld* constantly remain under strict anti-trust observation aimed at preventing cooperative pricing which might lead to disadvantages for the customers (Oum/Park/Zhang 2000, p. 14).

oneworld's Organisational and Management Structure

In order to succeed and be stable over time, a number of requirements and premises have to be met, such as an appropriate organisational structure.

oneworld alliance has opted for the following option: It is completely owned by its member airlines. It was the first of the globally operating airline alliances to establish a central unit responsible for the current and future management of the alliance. Only 15 months after its foundation, the *oneworld Management Company* (oMC) started to work in the newly-established headquarters in Vancouver, Canada, presided over by the Managing Partner. The company is governed by a board comprising the CEOs of each of the *oneworld* member airlines, who meet regularly in order to set strategic direction and goals and to review the achieved progress (oneworld 2010, p. 7). The location of Vancouver was selected because it is convenient to do business with all *oneworld* members during the same working day. Vancouver is convenient as far as the individual *oneworld* carriers are concerned since it is a handy crossover point between North America, Europe, and Asia (oneworld 2010, p. 7).

The alliance members are not as strictly bound by exclusivity stipulations as are members of the *Star Alliance*, for instance. *oneworld's* governance structure can be described as rather democratic and consensus-seeking. Consequently, the role of the central management company in Vancouver is that of a forum for communication and a coordinator for cross-airline working groups which are drawn from executives across all member airlines (Kleymann/Seristö 2004, p. 24). In order to assist the working groups in working across their many different countries and time zones, wide usage is made of technology, e.g. emails, eRooms, or dedicated intranet. For this purpose, the compatibility and correspondence of IT systems between the different airlines is necessary.

Branding and Identity

In international alliances, the question of an adequate brand management is crucial to the alliance's success. In the case of the *oneworld* alliance, ownership of the alliance brand resides with the member airlines themselves rather than with the management company. The size of equity in the brand mirrors the relative size of each carrier. Currently, brand-building activities focus mainly on vision, brand promise, corporate visual identity and corporate advertising. In terms of vision and brand promise, the creation of a clear statement of vision was a key element in the brand-building activities of the brand, addressing the two key stakeholder groups, the customers and member airlines and encapsulating the brand promise in the brand's strapline ("The airline that revolves around you"). *oneworld* has realised the importance of congruency so that service delivery, communications and reputation support and reflect the brand promise. For instance, *Finnair* is seen to contribute to the vision in terms of its Nordic route coverage and good reputa-

tion. On the other hand, *oneworld* has also recognised diversity and the particular strengths of individual airlines in that each member disposes of its own vision contributing to the alliance's vision; in the case of *Finnair*, it is: "Value creation and competitive advantage by being the champion of one-world's Nordic dimension". As for the corporate visual identity, the creation of a distinctive identity is a prerequisite for a strong corporate brand.

Summary and Outlook

"In no other industry have formal, multilateral alliances been built to such an extent, and with such speed, as in the airline industry" (Kleymann/Seristö 2004, p. 75). During the last two decades, airline alliances have become truly prevalent since they are an attractive substitute for a formal merger or acquisition (He/Balmer 2006, p. 242). It is often estimated that the growth of airline alliances will persist since the "mega carriers" will continue to face severe difficulty in establishing either their own, independent global networks or successful merger and acquisitions (M&As) for a number of reasons. For example, tremendous financial means are required which normally exceed the carrier's means. Also, despite current liberalisation steps, a number of legal, political and institutional constraints on M&As between airlines of different national origin will remain, not least due to pride in national carriers, rendering M&As much more difficult or even impossible. It is probable that the new open skies deals between the European Union and the USA might also affect airline alliances. True open skies could obliterate any remaining protectionist rules altogether and thus render alliances superfluous. However, these changes cannot be expected to take place any time soon due to the extremely high investments which have been made by the airlines. Also, even without any flight restrictions, it is still a lot less expensive to sell tickets on a partner's plane than to operate one's own. Thus, any changes will be of a very slow pace and airline alliances will remain stable at least in the middle or even long term.

oneworld as the smallest of today's three strategic airline alliances has successfully established itself in this very dynamic, ever-changing industry still facing many regulations. In this competitive and changing environment, it is crucial for the alliance to constantly review its partners and carefully check if a joining member fits with the global strategy and network. *oneworld* currently strives to strengthen its network with Shanghai-based carrier *China Eastern* and also discusses membership with *Hainan Airlines*, another important Chinese carrier.

Questions

1. When the first airline alliance, *Star Alliance*, commenced in May 1997, scepticism was high. How do you evaluate the overall success of alliances in the airline industry? What are the main internal and external factors for successfully establishing an airline alliance?
2. Airline alliances can be systemised in terms of their degree of integration. Compare the three major airline alliances by pointing out their regional strengths and weaknesses and also by ranking them according to their degree of integration.
3. Compare strategic alliances in the airline industry to mergers and acquisitions. What are the different types of M&As and how probable do you estimate the emergence of airline M&As in the future?

Hints

1. See e.g. Gudmundsson and Rhoades 2001 for success factors for alliance duration and survival.
2. See the websites of the three major airline alliances to gain an overview of the alliances' respective status quo.
3. See e.g. Kleymann and Seristö 2004, pp. 1-26, for a discussion of M&As in the airline industry.