

**A STRATEGIC ANALYSIS OF THE ONEWORLD
AIRLINE ALLIANCE**

by

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ABSTRACT

Global airline alliances enable member airlines to increase profits. They achieve this by increasing customer willingness to pay and reducing costs. Deep levels of partnerships are required to drive these benefits. The ability for partners to closely integrate is largely dependent on antitrust immunities being granted by regulators, which enable joint venture partnerships. The Oneworld alliance is poised to capitalize on a recent decision by the United States Department of Transportation and European Union Regulators to grant antitrust immunities between its two largest partners, American Airlines and British Airways. However, the Oneworld members must increase both their alliance's network size and the depth of partnerships if they are to optimize profits from their alliance.

Keywords: Global Airline Industry; Alliances

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EXECUTIVE SUMMARY

Global airline alliances enable their membership to increase profits. They accomplish this through increasing customer willingness to pay and by providing opportunities for members to reduce costs through operational efficiencies. These benefits might also occur through industry consolidation. However, the current regulatory environment rarely allows for cross-border mergers and acquisitions in the airline industry. Alliances are therefore an interim solution. Three major global airline alliances exist: Star Alliance, Skyteam and Oneworld. This paper examines the alliance strategy employed by the Oneworld partners. Their strategy has both strengths and weaknesses. The alliance has been very selective in its choice of partners, which has enabled the group to maintain a consistently high quality product and service level. However, the strategy has led to a relatively small network size. As a result, Oneworld has fallen behind the competition in terms of size of membership. Oneworld has also been less successful than the competition in driving deep integration between partners. Evidence suggests that these two factors may be affecting Oneworld's ability to increase profits through their alliance. The Oneworld partners must grow their alliances' network size and increase integration if the group is to optimize profits from its alliance.

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GLOSSARY

AA	American Airlines
ACCC	Australian Competition and Consumer Commission
ASKs	Available Seat Kilometres
ATI	Anti-trust Immunity
BA	British Airways
CAPA	Center for Pacific Aviation
CX	Cathay Pacific Airways
DRD	Delivery Requirements Document
DOT	Department of Transportation
DOJ	Department of Justice
EU	European Union
IACG	International Airlines Consolidation Group
JB	Joint Business
oGB	Oneworld Governing Board
oMT	Oneworld Management Team
oMC	Oneworld Management Company

1: INTRODUCTION

The Oneworld alliance is a strategic grouping of twelve international airlines. The membership consists of American Airlines, British Airways, Cathay Pacific Airways, Finnair, Iberia, Japan Airlines, LAN, Malév Hungarian Airlines, Mexicana, Qantas, Royal Jordanian and S7 Airlines. It is one of three global airline alliances; Star Alliance and Skyteam are its competitors. Global alliances have become an important component of the strategies of a growing number of international airlines, accounting for 55% of the world's international air traffic. The alliances are widely seen as an interim solution to widespread industry consolidation. They have formed due to a regulatory environment that rarely permits cross-border mergers between airlines. Foreign ownership restrictions often stipulate that a majority of voting stock and key management positions be held by citizens of that country. A primary reason for foreign ownership restrictions is the fact that airlines have historically been considered critical to a country's national security. Commercial aircraft are often "conscripted" during times of war. Another reason is protectionism. Labour unions see foreign competition as a threat to job security. Alliances therefore offer an alternative for airlines to achieve some of the same advantages of mergers. This is important to an industry that lost a combined \$US 47 billion over the past ten years (Deutsche Bank report, p. 17-27).

Alliance membership has grown substantially over the past decade. This leads to the presumption that member airlines are successful in deriving additional profits from their alliances. This paper seeks to understand the benefits that the Oneworld partner

airlines achieve from their alliance. The strategic analysis begins with a description of the Oneworld alliance (in chapter 2) and the airline industry landscape (in chapter 3). Chapter 4 then looks at the economics of airline alliances. It demonstrates that alliances can benefit their membership in two ways. First, they enable partner airlines to increase customer willingness to pay. Second, they provide opportunities for members to operate more efficiently. This combination leads to incremental profits for partner airlines. Chapter 5 examines the specific alliance strategy adopted by the Oneworld partners. It looks at strengths and weaknesses of the strategy and identifies key threats the alliance is facing based on its positioning. Chapter 6 considers the most likely scenario for the Oneworld partners if the current strategy is maintained and industry trends continue. It concludes that the Oneworld partners will not be in a position to maximize profits through their alliance unless the grouping expands its alliance network through a more ambitious membership recruitment drive. Chapter 7 introduces several options for increasing the Oneworld alliance network size. Chapter 8 utilizes a multi-goal solution analysis to evaluate membership growth options. The resulting recommendation is that the Oneworld partners pursue membership expansion through recruitment of non-traditional low cost carriers (this strategic group of airlines will be detailed in chapter 3) and through international mergers. The paper also recommends that the Oneworld partners look to increase the depth of integration between its members to ensure profits are maximized through their alliance.

2: THE ONEWORLD ALLIANCE

This chapter provides a description of the Oneworld airline alliance. It begins with an overview of the alliance's membership. It then details the governance structure of the alliance.

2.1 Membership

The Oneworld alliance is comprised of twelve member airlines. The current membership includes American Airlines (the United States), British Airways (The United Kingdom), Cathay Pacific Airways (Hong Kong), Finnair (Finland), Iberia (Spain), Japan Airlines (Japan), LAN (Chile), Malév Hungarian Airlines (Hungary), Mexicana (Mexico), Qantas (Australia), Royal Jordanian (Jordan) and S7 Airlines (Russia). Two new member airlines are also set to join: Kingfisher Airlines (India) and Air Berlin (Germany). The partners fly to 750 destinations in 150 countries. The membership also operates 550 airport departure lounges around the globe (source: Oneworld.com).

2.2 Governance

The Oneworld Alliance has two tiers of governance. They are, in order of authority, a Governing Board and a Management Team. All other alliance groups report to these two tiers.

2.2.1 Oneworld Governing Board (oGB)

The Governing Board holds the highest authority within the alliance. The group is comprised of one Chief Executive Officer from each Member Airline. The oGB is responsible for ultimate management of the Alliance. Key decisions include setting the Oneworld vision, and final approval of strategy, business plans, budget and membership decisions.

2.2.2 Oneworld Management Team (oMT)

The Management Team reports to the Governing Board. The oMT is comprised of senior managers from the alliance departments of each airline. It leads and approves overall strategy, business plans, headcount and budgets. The group is also responsible for evaluation of any potential new members and the resolution of any issues between members, prior to referral to the oGB.

2.3 The Oneworld Management Company

The Oneworld Management Company (oMC) is a company that was incorporated to coordinate alliance activities. It report into the oMT. No alliance groups report into oMC itself. oMC is primarily a project management office that facilitates the development of an annual business plan but is not empowered to set overall alliance strategy. Airline representatives on the oMT and oGB set strategy for the alliance, based on input from Airline Steering Groups (described below). oMC works with these groups to coordinate and guide preparation of business plans and budgets.

oMC's head office is located in Vancouver, British Columbia. The alliance's members own oMC. Each partner airline contributes to an annual budget based on their

proportional size. The size of each member is determined by a standard airline industry measured called Available Seat Kilometers¹ (ASKs). American Airlines and British Airways, being the two largest partners, pay just under half of total alliance expenses. Japan Airlines, Cathay Pacific and Qantas are the three next largest partners. These five partners account for 85% of funding for the alliance.

2.4 Airline Steering Groups

Oneworld has established Airline Steering Groups to act as support for the alliance in achieving their goals (see appendix A for a list of Oneworld Groups). These Groups report to the oMT. They are responsible for their areas of expertise. Responsibilities include translating the Oneworld vision into achievable objectives through the annual business plan and budget. They must also provide appropriate resources, primarily in the form of their own airline staff with necessary expertise, to ensure delivery of the annual plan.

2.5 Delivery Requirements Document

Oneworld members must prove that they meet certain criteria prior to joining the alliance. Each recruit must meet a number of membership expectations, which are defined in a Delivery Requirements Document (DRD). Members must support the Oneworld brand and deliver the Oneworld customer benefits as outlined in this document. A number of automation system requirements are incorporated in the DRD, which must interface with other alliance partners. Examples of automation requirements

¹ Airline Seat Kilometers is common industry measure that multiplies the number of seats available on a flight by the number of kilometers flown. It therefore measures an airline's capacity for transporting passengers. For example, an aircraft configured to fly 100 seats flying 160 km would give the carrier 16,000 ASKs for that particular flight.

include: data exchange for frequent flyer programs, and the ability to transfer baggage when a customer transfers from one partner airline to another. oMC, in conjunction with the oMT, is responsible for ensuring that each DRD is adhered to and each member continues to comply with the terms of the agreement.

The DRD includes an underlying pledge to alliance customers. It states that each partner's top tier² frequent flyers will be treated with the same care, regardless of which member airline they fly on. This means that each member airline should treat any partner's top tier passenger as they would their own. For example, top tier customers should be able to access any partner airline's lounge in any given airport, if travelling on an eligible Oneworld flight. The alliance does not have a its own frequent flyer program. Each individual airline maintains their own program. However, Oneworld does have a set of gemstone classes (Ruby, Sapphire and Emerald), which correspond to the partner airline frequent flyer programs. These gemstones are included on the frequent flyer cards of each member airline to indicate the level of alliance recognition (see appendix B for a summary of Oneworld gemstones and alliance benefits). An example of an alliance benefit is access to any lounge operated by a oneworld partner airline within any airport across the globe. Passengers also earn frequent flyer currency when travelling within the alliance network. A British Airways Gold cardholder would therefore collect miles in his or her account when travelling on an American Airlines flight from Dallas to New York. The traveller would also earn points toward achieving Gold level tier status for their annual membership. Like all other DRD requirements, audits are conducted on an annual

² A top tier passenger is any customer that has achieved status recognition in an airline's frequent flyer program. This is generally accomplished by flying a significant number of flights on an annual basis.

basis to ensure members are providing other alliance partners customers with the necessary frequent flyer benefits.

3: THE INDUSTRY LANDSCAPE

This chapter provides a description of the airline industry. It begins with a look at the industry's customers. It then explains how three distinct types of airline business models have evolved to cater to diverse customer needs (network airlines, low cost carriers and super connecting carriers). It seeks to demonstrate that partnerships are an important element of the industry. The chapter concludes with a description of various partnerships, beginning with minimal cooperation and extending to joint ventures and full mergers.

3.1 Industry Customers

The customer base for passenger airlines is very diverse. A passenger who travels on Southwest Airlines twice a year is a very different customer than an Executive Platinum cardholder in American Airline's AAdvantage program. The Southwest passengers could be a family that travels once a year on an annual vacation, whereas the American Airlines passenger may fly for business several times a month. Passengers who are flying on company business are known as corporate travellers. They generally travel at the expense of their employer. The corporate traveller comprises a small percentage of total passengers but accounts for a significant portion of total revenues. For example, A Singapore Airlines estimates that passengers in premium cabins, which are primarily corporate travellers, accounts for approximately 40 percent of their revenue (eTurboNews, May 2009). Passenger who are not travelling on business, typically for vacations, are leisure passengers. Leisure passengers are far more price sensitive than

corporate travellers. Corporate travellers are often willing to pay more for added service benefits. Airlines therefore provide several cabins of service to cater to varied customer demands. For example, customers purchasing a ticket on a British Airways long haul international flight can choose from four cabins: Economy Class, Premium Economy, Business Class or First Class. Table 1 provides an example of pricing on a one-way British Airways flight from Vancouver to London (in Canadian dollars, excluding taxes, fees, charges and surcharges, on May 13, 2011).

Table 1: Example of British Airways fares from Vancouver to London

	Economy	Premium Economy	Business	First
Vancouver -London	\$ 462	\$903	\$ 2,169	\$ 6,591

Source: www.ba.com

This example illustrates that the pricing for each cabin varies significantly. Customers who travel in Business and First Class cabins are often corporate travellers. Leisure passengers typically book the lower fares in Economy class.

3.2 Passenger Airline Types

Three distinct business models have emerged to cater to the varied industry customer base: 1) network airlines, 2) low cost carriers and 3) super connecting carriers. The following section provides a description of each business model.

3.2.1 Network Airlines

The first grouping is network airlines. These carriers often originated as national airlines, operated as government businesses. They are the flag carrier of their home

country, given their origins as regulated businesses. A legacy of being state run is often that these organizations are left with high cost structures, old technology systems and long supply chains that involve a wide range of intermediaries. Network airlines also tend to have high employee costs due to seniority of service amongst pilots, cabin crew and other employee groups. Network airlines often rely heavily on revenue from passengers in their business and first class cabins to drive profits.

Another distinguishing characteristic of network airlines is the hub and spoke business model. A majority of network airlines employ this strategy. It began in the 1980s when deregulated US passenger airlines looked to copy the FedEx hub-and-spoke system. The model assumes it is more efficient to fly passengers via large hub airports rather than taking them straight to their destination, as Fed Ex³ does with their parcels (SRI International, p. 80-82). The model therefore relies on ‘feeder’ flights to deliver passengers into the hub. Passengers then connect onto a wide range of destinations. This enables network airlines to more fully utilize relatively large airplanes and lower their average cost per passenger. An example of a traditional legacy carrier is American Airlines (AA). AA began as one of the major regulated airlines in the United States. It is now a de-regulated airline with five ‘cornerstone’ hubs across the United States: Dallas, New York, Chicago, Los Angeles and Miami. The airline operates both domestically and internationally, with an increasingly strong emphasis on long haul international routes.

3.2.2 Low Cost Carriers (LCCs)

The second type of airline is the low cost carrier (LCC). These newer companies operate from a lean cost base. The business model removes a number of complexities

³ Fed Ex is a cargo airline and courier delivery company (www.fedex.com).

generally associated with network airlines. LCCs generally offer only one cabin of service – economy class. They also often utilize secondary airports (for example, an LCC may choose to operate out of Luton Airport in Great Britain, rather than London Heathrow). The benefit is that take off and landing fees are significantly lower from the secondary airport. It is also common for LCCs to operate a single fleet type. This delivers significant cost savings through the relative simplicity of training crews and maintaining one type of aircraft. A final important characteristic is flying point-to-point. LCCs tend to fly routes directly, thus avoiding the complexities of transferring large volumes of passengers from one airplane to another. This is the opposite of a hub-and-spoke network strategy. The simplicity of the business model enables LCCs to better utilize their aircraft. They accomplish this by having shorter turnaround times. Southwest Airlines is an excellent example of an LCC. The airline primarily operates a single fleet type of Boeing 737s, with one cabin of service, often from secondary airports (for example, their hub is located in Dallas Love Field, rather than Dallas Fort Worth), has a very low cost base and runs a very efficient and profitable operation (Govindarajan and Lang, July 2002).

3.2.3 Super-Connecting Carriers (SCCs)

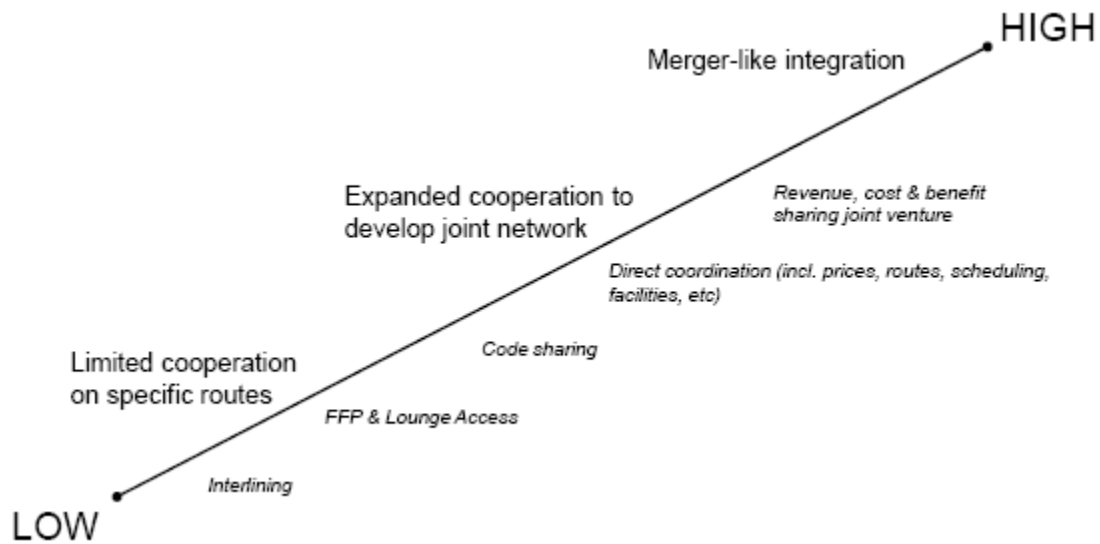
The last category of airline is the super-connecting carriers (SCC). **The Economist** magazine coined this term, in a 2010 profile of Emirates, Etihad Airlines and Qatar Airways. These three airlines are located in the United Arab of Emirates (UAE). Their business model requires the operation of large, long-range aircraft from strategically located hub airports in the Middle East. Each airline flies a wide-range of non-stop routes. They have exceptional customer service in their business and first class

cabins, which makes the product very attractive to passengers who are travelling on business. Emirates, Etihad and Qatar Airways operate from lower cost bases than traditional network airlines. There are two key areas of cost savings: lower employee and airport costs. Emirates is the best example of an SCC. It combines an excellent product with a low cost base and has a flexible, highly productive workforce. Most cabin crew and ancillary staff are from the Indian subcontinent and South-East Asia and are paid relatively low wages for the industry. Emirates' employees do not pay income tax, the same as all other workers in Dubai, which means salaries can be much lower than their European and American rivals. The net result is staff costs are around 15% of overhead, against well over twice that for a typical network airline (**The Economist**, June 2010).

3.3 Airline Partnership Levels

A majority of network airlines have come to rely on partnerships with other carriers to extend their networks. Relatively few pairs of cities have enough customer traffic to sustain the need for a daily flight. Carriers therefore seek commercial partners that can help them provide greater network coverage and increased service options (US DOT-EU report, p. 4). These can be bilateral relationships, between two partners, or multilateral alliances amongst a larger grouping of partners. The level of partnerships varies. The chart in Figure 1, developed by the United States Department of Transportation (DOT) and European Union regulators (EU), provides a visual representation of the partnership spectrum. This spectrum can be summarized in four categories (from low to high): 1) interline and codeshare agreements, 2) immunized partnerships, 3) joint businesses and 4) full mergers.

Figure 1: Spectrum of airline partnerships



Source: US DOT-EU report on alliances

3.3.1 Interlining and Codeshare Agreements

Interlining and codeshare agreements are prominent in the airline industry. An interline agreement is a voluntary commercial agreement between airlines that facilitates passenger travel on itineraries involving multiple carriers. A typical agreement accounts for ticketing, baggage transfers, and other related services. Thousands of interline agreements exist between airlines globally (Deutsche Bank report, p. 28). However, these relationships have been superseded by more comprehensive codesharing partnerships. A codeshare agreement is a business arrangement where two airlines share the same flight. The agreement allows for seats on a flight operated by one carrier to be marketed and sold by another carrier under its two-letter designator code. A seat is purchased on one airline but is actually operated by another partner. Codesharing allows an airline to provide their customers with access to cities without having to offer extra flights (Wikipedia, March 2011). This level of relationship does not require alliance membership. It is practiced between both allied and non-allied airlines. However, the

global alliances play a significant role in driving airline interline and codeshare partnerships. Alliance members tend to keep passengers ‘within the family’ by feeding traffic onto their alliance partner flights before non-alliance flights. This is because allied-airlines tend to favour alliance partners in the financial terms of their interlining and code-sharing agreements (DOT-EU report, p. 8). It is therefore important to distinguish between two distinct opportunities for partnerships. The first is within-alliance partnerships. The second is the total number of partnership opportunities for an airline to interline with. The size of an airline’s alliance has a direct impact on both opportunity areas. As more airlines join global alliances it creates opportunities for increased cooperation within that alliance, while simultaneously reducing the opportunity for airlines outside of that alliance to partner with the newly allied airlines. Again, this is due to the fact that allied airlines tend to favour interline partnerships with their alliance partners.

3.3.2 Immunized Partnerships

Immunized partnerships refer to airlines that have been granted immunities from antitrust laws by regulatory bodies on specific routes. United States antitrust law is a body of laws that prohibits anti-competitive behaviour and unfair business practices. Antitrust laws are intended to encourage competition in the marketplace. These laws make practices illegal if they are deemed to hurt consumers. Governments have competition regulators that apply the antitrust laws in order to prevent market failure. Other countries use the term ‘competition law’, including the European Union (EU), which also has a wide body of competition regulations (Wikipedia, 2011). In recent years, government regulators within the United States and EU have granted a number of

airline partners 'antitrust immunity' (ATI). This allows partner airlines to explicitly collude on specified routes. It is essentially permission, granted by government regulators, for airlines to work together in ways that would otherwise be anti-competitive and illegal.

The argument for granting ATI is complicated but can be attributed largely to downward pressures these partnerships place on airfares (the concepts will be covered in detail in Chapter 4: The Economics of Airline Alliances). The appeal of ATI to airlines arises from several sources. For example, by coordinating flight schedules and ensuring gate proximity at connecting airports, alliance partners can offer greater convenience to passengers. Alliance travel thus resembles single-airline service, avoiding many of the inconveniences of a traditional trip that requires a transfer between two airlines (Brueckner and Whalen, p. 504). This type of activity, involving coordinating flight schedules between two competitive airlines, would otherwise be deemed illegal by Federal authorities, thus the need for immunities to be granted. ATI also enables partner airlines to coordinate efforts in sales, marketing, product alignment and other areas of mutual benefit.

3.3.3 Joint Businesses (JBs)

The formation of a joint business (JB) is dependent on immunized partnerships. It takes the level of integration a significant step forward by creating an environment where partner airlines share revenue on particular routes. This means that the airlines involved in the JB are indifferent as to which aircraft carries a passenger (Deutsche Bank report, p. 28). The reason for this is that revenues are pooled on the affected routes and shared across the JB partners based on an agreed percentage formula. This form of cooperation

is a close substitute to a merger as it involves full coordination of major airline functions, including scheduling, pricing, revenue management, marketing, and sales (US DOT-EU report, p. 7). Integrated JBs provide a strong incentive to cooperate because individual carriers no longer seek to maximise their own revenue, but rather the revenue of the network. However, JBs with revenue sharing agreements are complicated to set up and are therefore not practiced by all airlines that enjoy ATI partnerships.

A good example of a JB exists between Oneworld partners American Airlines (AA), British Airways (BA) and Iberia (IB). The three partners created a common business on transatlantic routes in October 2010. Revenues on all flights from the United States to Europe (and vice-versa) are now shared among the partners. AA, BA and IB therefore no longer compete for customers on these routes, which account for over 20% of Oneworld's international traffic (OAG reports, March 2010). In a recent interview for Airline Leader magazine, BA's CEO, Willy Walsh explained how efforts are now coordinated to attract travellers. "A key part of the revenue sharing agreement is our ability to sell seats on each other's flights," said Mr Walsh. "This wider cooperation and support will enable us to operate routes that would not be viable if we could only sell to our individual airline's customer base. British Airways will start flights from Heathrow Terminal 5 to San Diego in June next year. Connoisseurs of the BA route network may know that this is the third time that we have launched this particular route. I think that serves to highlight the benefits of the joint business – the route did not deliver a profitable return for BA in isolation but we are extremely confident that, by working together with our colleagues, it will." (Airline Leader, p. 12).

3.3.4 Mergers

The final level of partnership is a merger between two airlines. Airline mergers and acquisitions have historically been largely confined to domestic markets. This has been caused by widespread regulatory restrictions on foreign ownership of airlines. Over the past two decades a number of events have occurred that are changing restrictive aviation regulations, including 1) the introduction of “Open Skies” agreements, which significantly reduce government regulations in the industry and allows foreign airlines to operate freely between countries; 2) creation of a common aviation marketplace and regulatory regime for the entire European Union; 3) antitrust immunities granted to airline partners by the US Department of Transportation and other regulatory bodies; and 4) relaxation of foreign ownership restrictions in a number of countries, often in an attempt to attract foreign financing for airlines in financial distress (Deutsche Bank report, p. 2). These events are creating a regulatory environment that will likely be more welcoming to cross border airline mergers in the future.

3.4 Summary of Industry Landscape

Three strategic groups of airlines were discussed in this chapter: network airlines, low cost carriers and super connecting carriers. The strategies for each are tailored to meet the needs of a varied industry customer base. One characteristic, common to many airlines, is the need to offer its customer base access to a wide ranging network.

Regulatory restrictions and commercial realities make it impossible for any one airline to provide services around the globe. Airlines therefore rely on partnerships to extend their network. The level of partnerships varies in depth. Partners in global alliances are increasingly deepening their level of cooperation and moving towards joint business

relationships. This level of integration leads alliance partners to become indifferent as to which flights the customer chooses, as all revenues are shared. These alliances are as close to a merger as possible within the current regulatory environment.

4: ECONOMICS OF AIRLINE ALLIANCES

The economics of airline alliances are detailed in this chapter. It explains how airlines can utilize alliances to increase profits. They accomplish this by 1) improving pricing, 2) reducing costs, 3) increasing customer willingness to pay and 4) reducing industry rivalry. The following section examines these impacts and how each results in increased value created and captured for alliance member airlines.

4.1 Improving pricing

The first impact of alliances on airfares is to create value by establishing better pricing for customers when two airlines partner to create an interline fare. This is accomplished through the removal of double marginalization. Double marginalization occurs when the fares of two non-allied airlines are combined to form a customer journey. In these cases there is no coordination between the two parties. The two airfares are determined independently. Each carrier chooses a sub-fare for its portion of the interline trip. If no cooperative price setting mechanism is in place, each carrier will set its sub-fare to maximize its own profit. The result is each carrier charges a sub-fare that is a mark up on the marginal cost for profit maximization. Since there is no coordination of these mark ups, the combined total fare will therefore not maximize the joint profits of the two carriers. This is not in the best interest of the airlines or their customers. Airlines within alliances therefore adopt cooperative pricing mechanisms that result in sharing of revenue arising from interline traffic. The carriers work together to set interline fare levels that maximize their joint profits (Zou, Oum, Yu, p. 320). Double marginalization is

therefore eliminated, which leads to downward pressure on interline fares, increasing value created. As well, more value is captured by airlines as profits.

4.2 Reducing costs

Alliances enable member airline to reduce costs. They do this in a number of ways. The first is through increasing economies of traffic density. These economies emerge when airlines are able to lower their per passenger costs by increasing the number of passengers carried on their existing network. This phenomena was first observed in studies of hub-and-spoke airport models. Airlines adopted hub-and-spoke strategies in an effort to feed passengers from regional airports through their hubs. This funnelling of passengers through airports raised traffic densities and enabled carriers to reduce their costs by operating larger, more efficient aircraft with increased load factors⁴, which reduces average cost per passenger (Brueckner & Whalen, p. 506). This phenomena is accelerated by global airline alliances. When a large group of airlines cooperate by joining their respective feeder flows, the partnerships create a larger pool of customers and cost savings are realized by carrying additional passengers on an airlines' existing flights (US DOT-EU report, p. 21). The growth of alliance networks can be understood as an attempt to exploit economies of traffic density, under which the marginal cost of carrying an extra passenger on a route falls as traffic on the route rises (Brueckner & Spiller, p. 380). Economies of traffic density therefore reduces costs and increases value created.

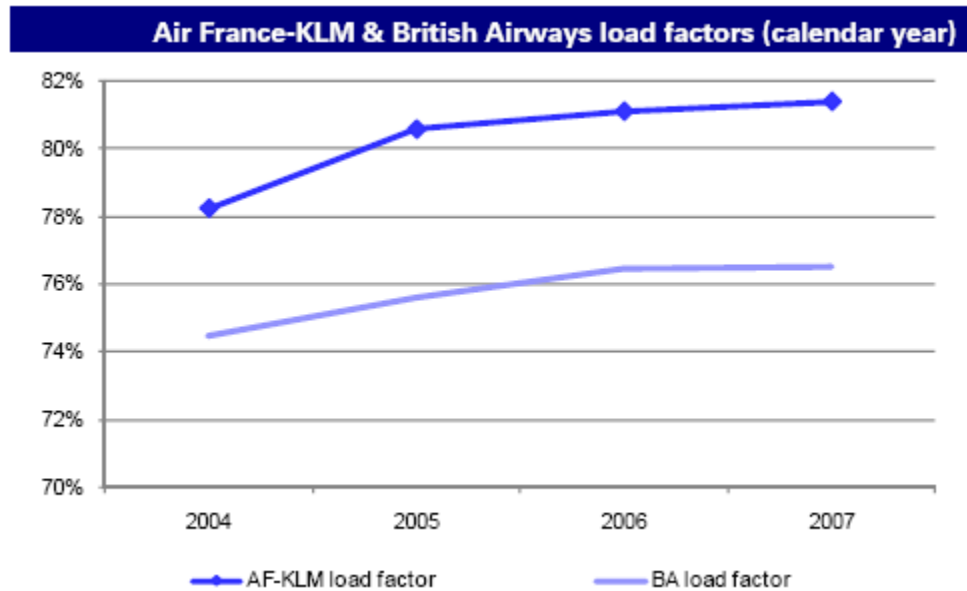
⁴ Load factor measures the percentage of the total available seats of an airplane that are filled during a flight.

Alliance partnerships can also drive significant asset efficiency. A good example comes from two Oneworld alliance partners. British Airways and American Airlines recently announced a joint New York-London schedule for the spring of 2011. The partners have worked together to spread out their flight times. Flights that used to be bunched together are now spread apart. Customers are offered a flight departing every hour from New York City to London Heathrow. By cutting overlapping flights, only 11 daily flights are offered instead of 12. The partners are therefore creating more revenue, and providing a better customer service, with 10% less aircraft required (Deutsche Bank Report, p. 34). It is important to recognize that the ability for airlines to coordinate schedules on competitive routes is dependent on ATI being granted. The schedule alignment between British Airways and American Airlines would have been deemed as collusive had the two partners not been immunized across the Trans-Atlantic by UK and US regulatory authorities.

A second example involving British Airways shows the importance of ATI. Figure 2 shows Air France-KLM's load factor following the creation of their immunized joint business in 2004. The load factors rose faster for these two partners than they did for British Airways over the same period. Air France-KLM accomplished this by cutting duplication on routes while offering more frequency of flights to the customer (Deutsche Bank report, p. 35). British Airways can expect to see a similar result from the joint business they have established with their Spanish partner, Iberia, in October 2010. It is likely that the two airlines will witness a similar spike in load factors in 2011, when the benefits of their cooperation on scheduling take effect. This again illustrates the fact that the creation of alliances is not, in and of itself, enough to generate benefits from

membership. These benefits can only be achieved through deep alliance partnerships, often only after ATI has been granted.

Figure 2: Impact of Airfrance/KLM merger on load factors



Source: Deutsche Bank report (2010)

Alliance partnerships also open opportunities for shared facilities. For example, American Airlines, British Airways and Iberia recently announced the opening of their first joint airport lounge, in Miami. The new premium lounge is larger than any of the partner's previous lounges. The shared lounge enables the partners to share expensive airport real estate. The fact that airline flight times are varied throughout the course of the day means that the facility will be more efficiently utilized, as independently operated airline lounges often sit empty for large portions of the day when there are no departing flights. The net result is the sharing of significant costs and better capital asset utilization.

4.3 Increased customer willingness to pay

Alliances enable airlines to create value through increasing the ability to raise fares for business travellers. They accomplish this through the existence of service premiums. Zou, Oum and Yu (2010) argue that alliances provide airlines with an enhanced ability to increase customer willingness to pay. These premiums are generated through benefits that customers value, such as enhanced connecting services, premium check-in, better schedule coordination and more convenient connections. These services are intended to make customer journeys that require a transfer between two airlines as seamless as possible. The analysis conducted by Zou, Oum and Yu showed that the impact of these service premiums varied for different customer groups. Not surprisingly, leisure travellers displayed a limited willingness to pay for service premiums. They typically choose the lowest available fare. However, customers that booked fares in first class and business class were often willing to pay more for flights operated by alliance partners. The study concluded that corporate travellers are less price-conscious and value services that create a more seamless journey. This enables allied-airlines to introduce service premiums. Increased willingness to pay increases value created.

4.4 Reduction of rivalry

A final impact of alliances on airfares is a reduction in rivalry. When airlines cooperate on routes there is less competition in the marketplace. This is particularly true when airlines operate joint businesses and align flight schedules. For example, procurement experts for global corporations have suggested that the growing dominance of transatlantic alliances has fundamentally changed how airlines sell services to corporate travel buyers. Antitrust immunities have converted nearly a dozen distinct

competitors into three dominant entities (Star Alliance, Skyteam and Oneworld). This concentration of supplier power reduces corporate buyers' negotiating leverage. In a 2010 forecast, Bob Brindley, a vice president at Advido⁵, identified transatlantic joint businesses as a top concern for corporate buyers. He said that "the deals bring them (the customer) no benefits, with the discount from the whole being less than discounts previously offered separately by individual members of the joint venture. Worse still, there is evidence that joint ventures are using their newfound power to insist they are awarded city pairs currently operated by competitors" (Boehmer, March 2010). The impact of reduced rivalry within the industry is increased value captured by the airlines.

4.5 Summary of Alliance Economics

Alliances enable airlines to create and capture value in four ways. They enable airlines to improve pricing, reduce costs, increase customer willingness to pay and reduce industry rivalry. However, these benefits do not appear to be uniform across the alliances. The study conducted by Zou, Oum and Yu in 2010 looked at variances between the three alliance groupings. It showed that member airlines of Star Alliance and Skyteam were able to charge 14% higher premiums for their interline fares than those of non-allied itineraries. This effect was not witnessed for interline fares offered by the Oneworld Alliance. Their analysis showed that Oneworld partners were not able to charge premiums on their interline fares. There are a number of reasons why this may have occurred. For example, the Oneworld partners may have been less successful in reducing industry rivalry on the affected routes. However, Zou, Oum and Yu attributed the result to the fact that service benefits are not achieved by simply having an alliance relationship

⁵ Advido is a supplier of global corporate travel management services based in Dallas, Texas.

in place. They are dependent on well-coordinated integration and full cooperation (Zou, Oum and Yu, p. 328). Oneworld's inability to extract service premiums may therefore be a result of less alliance integration, relative to the other alliances.

5: ONEWORLD'S STRATEGIC POSITIONING

This chapter describes the strategic position of the Oneworld Alliance. It identifies both strengths and weaknesses of the alliance strategy. The chapter concludes by introducing external threats that Oneworld is facing, including: 1) the continued growth of LCCs, 2) the continued emergence of SCCs and 3) the fact that Oneworld's network is sparse within key growth regions for air travel.

5.1 Strengths of Oneworld's current position

The strength of the Oneworld alliance strategy rests on three fundamentals. First, the alliance's selective approach to membership has enabled it to maintain a high, consistent standard for products and services delivered by its member airlines. Second, the alliance is well positioned at four of the world's ten leading premium airports. Third, Oneworld's joint business between American Airlines, British Airways and Iberia on the North Atlantic provides an opportunity to coordinate efforts on the world's premier business travel route; New York's John F. Kennedy Airport (JFK) to London Heathrow (LHR).

5.1.1 Consistency of Product Offering

The Oneworld alliance partners have been very selective in extending invitations to new members. The group has positioned itself as the quality airline alliance by strictly adhering to the membership standards defined in the alliance Delivery Requirements Document. This has resulted in Oneworld being consistently recognized as the industry

leader for high quality partners. Oneworld's performance in various industry awards reflects this fact. The group won three prestigious best airline alliance awards in 2010, including: Global Traveller's Best Airline Alliance, World Travel Awards' Leading Airline Alliance and World Airline Awards' Best Airline Alliance (Oneworld Website, May 2011). Speaking at the 2010 World Airline Awards, Oneworld Vice-President Corporate Affairs Michael Blunt said, "Oneworld aspires to be the world's premier alliance, so we are thrilled to be judged the best by the people who really count - customers - in the biggest ever independent survey of international air travellers" (Skytrax World Airline Awards, May 2011).

5.1.2 Strength at Key 'Premium' Hub Airports

The Oneworld airlines are currently placed well in a number of the world's 'premium' hub airports. Premium hubs are determined by the capacity of business and first class seats that airlines fly to and from an airport. Figure 3 provides a summary of the top 10 premium airports in 2010. Oneworld is currently entrenched at four of these important hubs for business travellers. London Heathrow, Hong Kong, Tokyo Narita and New York JFK, via British Airways, Cathay Pacific, Japan Airlines and American Airlines, respectively. These four airports account for 45% of the world's total premium seats (Airline Leader report, p. 48). While Oneworld may not be the largest alliance, it is very competitive against the other alliances in those locations where premium business passengers travel most frequently.

Figure 3: Top ten premium airports

AIRPORT	FIRST CLASS	BUSINESS CLASS	TOTAL PREMIUM
London Heathrow	25,518	213,535	239,053
Dubai	30,050	134,015	164,065
Hong Kong	13,998	135,331	149,329
Frankfurt	15,972	112,030	128,002
Singapore Changi	12,026	94,997	107,023
Paris CDG	12,342	91,331	103,673
Amsterdam	1342	95,054	96,396
Tokyo Narita	12,612	81,320	93,932
Bangkok	7580	84,708	92,288
New York JFK	16,752	61,738	78,490

Source: Airline Leader report, 2010

5.1.3 North Atlantic Joint Business

Oneworld now has Anti-Trust Immunity (ATI) between its two largest partners on its most important routes. The announcement that US regulators had granted ATI between American Airlines and British Airways on transatlantic routes in October 2010 was likely the most important event in Oneworld's history. The immunity was also extended to three other Oneworld partners: Finnair, Iberia and Royal Jordanian. The granting of this immunity was followed shortly after by the announcement that American Airlines, British Airways and Iberia would form their Joint Business (JB) on the North Atlantic. This JB includes a full revenue sharing agreement. All tickets sold to customers for flights from the United States to Europe are now pooled amongst the three partner airlines and distributed based on an agreed percentage formula. These routes account for over 25% of Oneworld's network⁶ (OAG report, May 2011). The group's ability to deepen relationships opens potential for the partners to drive significant integration. For

⁶ OAG is a company that provides reporting tools for the airline industry. This measure is based on the total number of seats that are flown by the Oneworld partners across their airplane fleets.

example, the alignment of American Airlines and British Airways schedules means the partners now offer an hourly flights between New York JFK and London Heathrow. The joint business partners are also creating transfer support centres at Miami, New York, London Heathrow and Madrid. These transfer centres have been established to take care of passengers who have little time to make it to their next flight when transferring between the three airlines. Employees from the three companies staff the transfer centres. Their first role is to identify flights that have passengers on board with tight connection times. These passengers are then met at the aircraft by customer-service staff who ensure passengers catch their flights or rebook them on the next available flight if connections have been missed. This significantly enhances the customer and baggage transfer proposition amongst the alliance partners (Airline Leader, p. 13). Schedule alignment and the creation of Oneworld transfer centres are strong examples of deep alliance integration that increase value for both the airline members and customers.

5.2 Weaknesses of Oneworld's current position

The strategy of the Oneworld partners has created an alliance with a grouping of high quality partners who are well positioned in premium airports where business travellers travel most frequently. However, the strategy has left the Oneworld partners with two important weaknesses: 1) the alliance has a relatively small network, in comparison to Star and Skyteam and 2) the Oneworld partners are not as integrated as the other alliances.

5.2.1 Smaller Network

Oneworld is the smallest of the three alliances at 10.4% of total industry flights.

Table 2 provides a summary of total alliance flights in March 2010 and March 2011. The small size of Oneworld's network leads to three concerns: 1) reduced economies of traffic density, 2) reduced options for interline partnership opportunities due to the fact that airlines in other alliances prioritize partnerships with their Star Alliance or Skyteam partners and 3) less ability to eliminate industry rivalry.

Table 2: Number of flights operated by alliance airlines in March 2010 & 2011

	Mar-10	Mar-11	% change y-o-y	% of total Mar-2010	% of total Mar-2011
Flights					
oneworld	255,134	247,575	-3.0%	10.4%	9.6%
SkyTeam	345,747	364,415	5.4%	14.1%	14.2%
Star	609,696	648,707	6.4%	24.8%	25.2%
Un-Aligned FSA	786,786	818,337	4.0%	32.0%	31.8%
LCCs	459,255	494,765	7.7%	18.7%	19.2%
Total	2,456,618	2,573,799	4.8%		

Source: OAG data

The first issue created by Oneworld's smaller network is reduced economies of traffic density. Chapter 4 explained the economics of airline alliances and the advantages economies of traffic density provide network airlines. Higher levels of customer traffic funnelled through hub airports enables airlines to reduce their cost per passenger through the utilization of larger aircraft and increased load factors. The fact that Oneworld has a relatively small network will inevitably result in less traffic flowing through their hub airports.

A second issue will compound this problem for Oneworld. Alliance members tend to keep passengers within-the-family by feeding traffic onto their alliance partner flights

before non-alliance flights. This is because allied-airlines tend to favour alliance partners in the financial terms of their interlining and code-sharing agreements (DOT-EU report, p. 8). This leaves Oneworld in a weak position. Star Alliance now has 26% of the world's ASKs in their network. That means that more than a quarter of the airlines across the globe will be more likely to transfer their passengers onto their Star Alliance partners before they consider interlining with Oneworld members. The end result will be less opportunities for Oneworld partners to establish interline partnerships that could otherwise assist in driving up load factors on their flights.

The last issue Oneworld faces due to a smaller network size relates to less opportunities to reduce industry rivalry. The creation of alliance partnerships on competitive routes naturally reduces competition. This is particularly true when immunized relationships and joint business exist. For example, ATI approvals and the subsequent creation of JBs have converted nearly a dozen distinct competitors into three dominant entities on transatlantic routes (Star Alliance, Skyteam and Oneworld). Each of these groupings is now pooling revenues on these routes and coordinating schedules. While Oneworld has a strong position on the Transatlantic, it is less well positioned to remove rivalry in regions such as Europe and Asia, due its relatively small group of members. Less partnerships within the grouping inevitably means less opportunity to reduce rivalry.

5.2.2 Less Integration

In addition to having a smaller alliance network, Oneworld is less integrated than its competitors. Star and Skyteam have been more effective in deepening partnerships within their alliances. This was raised by Zou, Oum and Yu (2010) as a potential

explanation for Oneworld's inability to extract service premiums from business travellers. Their empirical evidence showed that business travellers were willing to pay significantly higher fares on interline journeys serviced by two Star Alliance or Skyteam members. However, the results for Oneworld members did not show any price mark-up for allied-interline services. One explanation for this may be a competitive disadvantage that Oneworld faced against the competition for the past several years. Meaningful alliance integration often requires the existence of ATI between key partners. Oneworld has been significantly behind the competition in receiving approvals. Figure 4 summarizes immunities between alliance partners prior to October 2010. Oneworld's lack of anti-trust immunities largely prevented the partners from working together in schedule alignment, joint marketing and other areas that require regulatory immunities. This put Oneworld at a distinct disadvantage versus Star Alliance and Skyteam. Oneworld has since received ATI amongst several other partners (this will be covered in Chapter 6). However, the benefits derived from these immunities would not have been available to Oneworld at the time of Zou, Oum and Yu's 2010 research. The evidence therefore suggests that, at least as of 2010, Oneworld is behind the competition in terms of deep integration between partners.

Figure 4: ATI between alliance partners prior to October 2010

 STAR ALLIANCE	 SKYTEAM	 oneworld
 		
<i>with</i>	<i>with</i>	<i>with</i>
       	    	

Source: Author

5.3 External Threats

The Oneworld alliance partners face a number of areas of concern moving forward. The following section identifies three major threats to Oneworld: 1) the continued growth of low cost carriers, 2) the emergence of super connecting carriers and 3) the fact that Oneworld is not well positioned in emerging markets.

5.3.1 Growth of LCCs

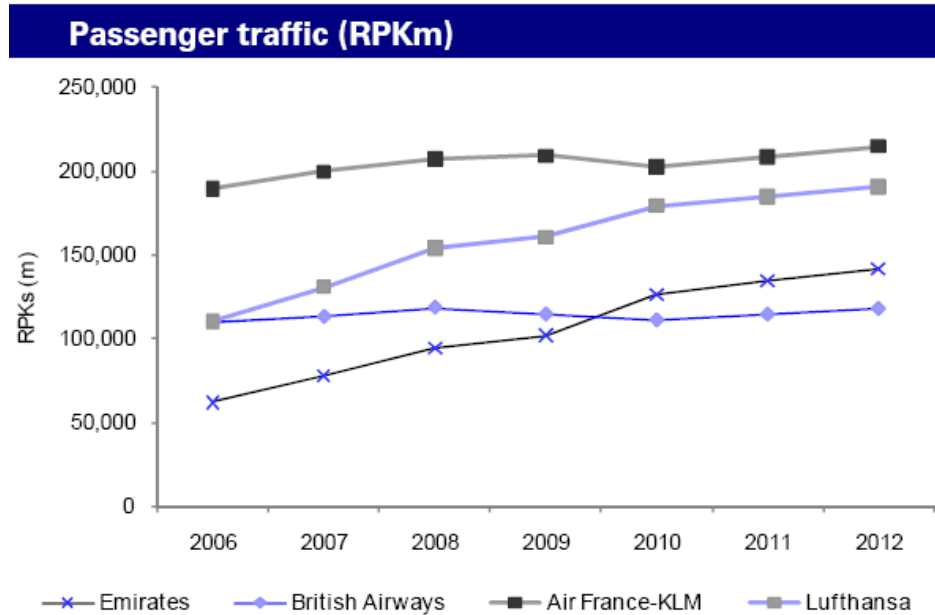
Low cost carriers (LCCs) have rapidly increased market share over the past two decades. LCCs now account for 23% of global airline capacity, compared to only 8% in 2001 (CAPA article, March 2011). Network airlines have increasingly focussed on long-haul international routes, unable to compete with the low cost base of these new generation airlines. Studies have shown that LCCs typically extend their market share to approximately 30 percent before reaching a ceiling (Gillen, p. 17). This has occurred in North America, Europe and Asia. A possible explanation may be that LCCs first attract

passengers disenchanted with the traditional network airline. After that point, they work to steal non-typical passengers. They do this by altering their business models. For example, LCCs are now increasingly gaining market share at primary airports, rather than being content operating from secondary airports, which tend to cater more to leisure passengers. Easyjet is now the largest short-haul carrier at London Gatwick and has become the second largest carrier at Paris Charles de Gaulle (Gillen, p. 17). A major presence at these primary airports raises costs for Easyjet but enables it to compete for lucrative business travellers. The danger for the Oneworld partners is that LCCs have reached their natural ceiling and are still looking for growth. They are increasingly looking toward business travellers, the typical network airline and alliance customer.

5.3.2 Growth of SCCs

The emergence of super connecting carriers (SCCs) from the Middle East has been equally impressive. Emirates, Etihad, and Qatar Airways represent a rising threat to European network airlines. The SCCs have been growing rapidly. Figure 5 shows that Emirates Airlines has now surpassed British Airways in terms of passenger traffic. It is also on course to gain ground on Air France/KLM and Lufthansa, Europe's two largest network airlines. The problem for the Oneworld partners is that these trends are likely to continue. The SCCs have significantly lower costs, excellent products and service a wide-range of destinations from their centrally located Middle Eastern hubs. Dubai, Abu Dhabi, and Doha are uniquely positioned on the globe, allowing for one-stop connections between major cities on six different continents (Deutsche Bank report, p. 80). This makes the SCCs a significant competitor for business travellers.

Figure 5: Comparison of Passenger Traffic



Source: Deutsche Bank report

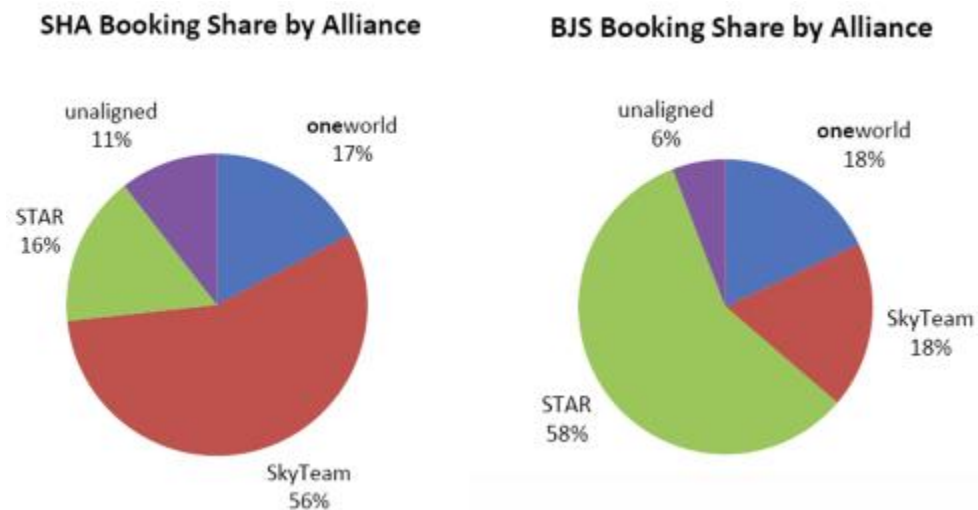
5.3.3 Sparse Coverage in Key Growth Regions

While Oneworld is currently well entrenched at a number of top premium airports, the alliance is not as well positioned moving forward. Airports in emerging markets are witnessing rapid growth. A recent report by the Centre for Pacific Aviation (CAPA) predicts the shape of the industry to be very different in ten years. The publication expects much greater representation of both Asia Pacific and Middle East hubs in the top thirty airports. In 2010, four of the top five fastest growing international markets were in Asia – China at 10.8%, the UAE at 10.2%, Vietnam at 10.2%, Malaysia at 10.1% and Sri Lanka at 9.5%. Announcing the forecast, IATA Director General and CEO Giovanni Bisignani said, “The focus of the industry continues to shift eastward. By 2014, one billion people will travel by air in Asia Pacific. That is 30% of the global total

and a 4 point increase from the 26% it represented in 2009” (CAPA Article, March 2011).

The largest problem Oneworld faces is that it is not positioned well in Asia. China will be by far the biggest contributor of new travellers in the future. Of the 800 million new travellers expected in 2014, 360 million (45%) will travel on Asia Pacific routes and, of those, 214 million will be associated with China (181 million domestic and 33 million international) (eTurbonews, February 2011). Figure 6 provides a summary of alliance market share in China. Oneworld has a relatively weak position in both Shanghai and Beijing, the two key aviation hubs within China. Skyteam is dominant in Beijing with their partners China Eastern and China Southern. Star Alliance is even more dominant in Beijing with their partner Air China. The three major Chinese airlines are therefore already members of the other alliances. This leaves Oneworld without a Chinese partner.

Figure 6: Alliance market share in China⁷



Source: MIDT (July 2008 - June 2009)

⁷ These charts show the total amount of tickets that were booked on airlines within each alliance in both Shanghai (SHA) and Beijing (BJS) from July 2008 until June 2009.

5.4 Most Likely Outcome

This chapter identified both strengths and weaknesses in the current positioning of the Oneworld alliance. The grouping has positioned itself as the quality airline alliance. Careful selection of membership has enabled the group to provide consistency in products and services. However, the group's relatively small network size leads to a number of disadvantages that will affect the ability to maximize profits through their alliance. The Oneworld alliance partners should be concerned that the total number of flights operated by its airlines was smaller in March 2010 than it was in March 2011 (as shown in Table 2). Oneworld's network size decreased by 3% over the period, while Star Alliance and Skyteam both grew their networks. The most likely outcome the Oneworld partners face moving forward is that their access to a wider customer base will continue to diminish if a new strategy is not adopted. This will result from two factors. First, the alliance is smaller than Star and Skyteam and will therefore have less opportunity for within alliance partnerships and for interline partnerships with non-allied airlines. As more airlines join the other alliances, it leaves less partnership opportunities available to the Oneworld airlines. As mentioned in chapter 3, allied-carriers tend to favour alliance partners for interlining and code-sharing agreements. This means that allied-airlines will often interline with their alliance partners before they look at partnerships with airlines in other alliances. This will be detrimental to the Oneworld partners as the pool of non-allied airlines continues to shrink. Second, Oneworld is not well positioned in key growth markets. This is particularly true in China. This is a major concern given the trends of global travel expansion. If Oneworld is not successful in obtaining new members these negative trends will continue.

6: SOLUTION ANALYSIS

The previous chapter concluded with the most likely outcome for the Oneworld partners if industry trends continue and their alliance membership strategy does not change. Partnership opportunities for the Oneworld airlines will continue to diminish, while Star Alliance and Skyteam will continue to grow their opportunities. Oneworld will therefore be left with a relatively small group of airlines with which to grow partnerships. This will reduce the ability for the members to create and capture value through interline agreements and alliance relationships. It is therefore likely Oneworld will continue to see its total number of annual flights decrease year-on-year. If this trend is to be reversed, the Oneworld airlines must adopt a more aggressive strategy for membership expansion. This chapter provides an analysis of potential options for growing partnership opportunities.

6.1 Multi-goal Analysis

A multi-goal analysis will be used to evaluate specific strategic options for growing Oneworld partnership opportunities. The model to be used was developed by Aidan Vining and Lindsay Meredith (2000). Their approach requires five steps: 1) generate a set of strategic options; 2) select a set of goals, against which to evaluate the strategic options; 3) predict the impact of the strategic options in terms of the selected goals; 4) value the predicted impacts in terms of the set of goals over the complete set of strategic options; 5) evaluate the complete set of strategic options in terms of the complete set of goals.

6.1.1 Strategic Options for Growing Alliance Partnership Opportunities

The first step in the multi-goal analysis is to generate a set of strategic options. The following four options will be considered for growing the number of partnership opportunities available to the Oneworld members: 1) pursue traditional network airlines that are not already alliance members; 2) partner with LCCs; 3) invite SCCs to join the alliance; and 4) poach partners from other alliances, through mergers and foreign direct investment.

The first option is to pursue any remaining non-allied network airlines. These full service airlines tend to fit the traditional mould of alliance partners. Malaysian Airlines is a good example. The airline has a very good product and meets all of the traditional requirements to be an alliance member. Its hub at Kuala Lumpur International Airport would be a good fit for Oneworld, which needs to expand its network in Asia. Other traditional non-allied airlines could include Hainan Airlines (China) and Gulf Air (Bahrain). This strategy would continue the status quo of recruiting traditional network airlines that are not already a member of an alliance.

A second option for partnership growth could come from LCCs. There is already a trend of alliances establishing partnerships with LCCs. Oneworld's announcement in 2010 that Air Berlin was joining the alliance is the most prominent example. Air Berlin unabashedly claims its position as an alternative service model (CAPA Article, March 2011). The airline is considered to be an LCC but its product offering is at the high end of the model. The carrier describes itself as "offering a high product quality combined with above-average service, while still keeping prices low" (CAPA report, March 2011). This allows Air Berlin to position itself between traditional network airlines and typical LCCs.

Several other examples of airlines at the upper end of the LCC business model include Westjet Airlines (Canada), Jet Blue (Eastern United States), Jetstar (Australia/Asia) and GOL Airlines (Brazil). This strategy would target those airlines that position themselves between typical LCCs and traditional network airlines.

A third consideration for expanding partnership opportunities is to extend invitations to the SCCs. Emirates, Qatar Airways and Etihad Airlines are the three available options within this strategy. These airlines have so far opted to remain independent of global alliances. They are strategically located in the Middle East and are continuing to expand rapidly. This strategy would involve selecting one of the three airlines as a partner. Given the close proximity of each airline and their overlapping routes networks, it is unlikely that more than one SCC would fit within a single alliance.

Mergers and foreign direct investment are the final option to be considered for expanding partnership opportunities. The list of non-allied network airlines has shrunk. However, the potential exists for poaching members from other alliance groupings through this option. A good example of this occurred in 2008 with the merger between United and Continental Airlines. Continental was a member of Skyteam prior to this date, while United was a Star Alliance member. Following the merger with United, Continental quickly defected to the Star Alliance (**Businessweek**, June 2008). The United and Continental merger also drove Copa Airlines to leave Skyteam. The airline, based out of Panama City, has strong partnership ties with Continental. It was therefore no surprise that Copa announced its intent to join the Star Alliance in 2010 (Star Alliance press release, November 2010). The example of United, Continental and Copa serves to illustrate that airline mergers could play a large role in re-shaping the global alliance

landscape moving forward. This strategy would involve the Oneworld partner airlines looking for opportunities to poach airlines from existing alliances when merger or foreign direct investment opportunities arise.

6.1.2 Evaluation Criteria

The second step in developing the multi-goal analysis is to identify evaluation criteria. A set of goals is required to assist in evaluating the four network growth options discussed above. The following goals are applied to the analysis: 1) maximizing network size; 2) improving quality of service; 3) minimizing internal partner conflict and 4) the ability for Oneworld to implement new partnership agreements quickly.

The first goal is maximization of network size. The benefits of an extensive alliance network were detailed in Chapter 4. A larger network of partnerships can lead to improved pricing, reduced costs, increased willingness to pay and a reduction in industry rivalry. Each of these will result in an increased ability for airlines to create and capture value. This is clearly an important consideration for the Oneworld partners if they are to maximize profits from their alliance.

The second goal is improved quality of service. This is important in ensuring that the Oneworld partners are able to increase willingness to pay for business travellers. Adding alliance members can potentially dilute the quality of service offered by an alliance. This is often true for partnerships with airlines from emerging markets, where consistency of products can be problematic. A recent example was referenced in a report by the Centre for Pacific Aviation, with a less than enthusiastic review of Skyteam's invitation to Saudi Arabian Airlines. The carrier has a number of unusual characteristics

that make it a challenging fit for alliance consistency. For example, it is fully owned by the government and entry and transit are both complicated by tight and expensive visa requirements. The nation and its national carrier, also do not have good reputations for their policies towards women and other groups. These two factors considerably complicate the use of its hubs as alliance transit points. The absence of alcohol and other state-imposed restrictions also reduce the airline's appeal for business travellers. The decision by Skyteam to invite Saudi Arabian airlines serves to illustrate the difficulty in maintaining a standard product among members (CAPA report, January 2011). The question this raises for the global alliances is: how much are the groups willing to accept service differentiation in attempts to extend their opportunities for partnerships? Additionally, as was shown in Chapter 4, alliance partners must position themselves to deliver exceptional services if they are to extract premiums on interline fares from business travellers. Dilution of standards for membership could result in a decreased ability to increase customer willingness to pay and reduce an airline's ability to create and capture value from their alliance partnerships. Consideration must therefore be given to the impact any new member will have on improving quality of service before an invitation is extended.

Alliances must also be careful to minimize inter-alliance conflict when a new member is invited to join. The addition of new members raises the potential for overlap and conflict between partners. This is due to the fact that new partners may fly routes that overlap with existing partners. If a new partner were to generate significant inter-alliance conflict, the negatives may outweigh the benefits of adding that airline to the group. These concerns can be reduced in situations where ATI is approved by regulators

amongst partners. The granting of ATI enables partners to cooperate on routes by aligning schedules and sharing revenues, which reduces industry rivalry. However, if immunities do not exist, so-called partners can end up competing against each other within the same alliance. In some cases, this can be detrimental to the alliance group. Consideration must therefore be placed on minimizing internal conflict when an airline is invited to join the alliance.

The last goal for consideration is the ability to implement a strategy quickly. This is an important consideration in the alliance environment where a strong first mover advantage exists. Once an airline commits to an alliance, it is rare that they defect. It is therefore important that efforts are prioritized so that constrained management resources can be dedicated to strategies that are realistic and quick to implement. If a strategy has a number of factors that will delay implementation for several years, it is likely an alternative option would be given preference. The multi-goal analysis will take into account speed of implementation.

6.1.2.1 Weighting of Evaluation Criteria

The final step in establishing evaluation criteria is to provide a relative weighting for each goal. It is often the case that a firm will place different levels of importance on each of its goals. However, for the purpose of this analysis it has been assumed that each strategic goal is of equal importance to the Oneworld member airlines. The reason for this is each member airline within the Oneworld alliance has its own unique corporate strategy. It is likely that each member would value the four goals differently. For simplicity, it is assumed that the Oneworld alliance partners place equal value on each of the four goals: maximize network size, maintain a consistent quality of service, minimize

internal partner conflict and the ability for Oneworld to implement new partnerships quickly. Each of the four goals will therefore be equally weighted at 25% of total utility.

6.1.3 Multi-goal Analysis Matrix

The next step in the multi-goal analysis is to consider each of the four strategic options for growing alliance partnership opportunities against the goals discussed above. In completing this exercise a score from 1-5 is assigned to rank the effectiveness of each alternative in achieving the defined goals. The following scale has been used for the analysis.

Figure 7: Relative weighting for strategic options

1	2	3	4	5
Low		Medium		High

Source: Author

Table 3 provides a summary of the multi-goal strategic analysis for growing the Oneworld network.

Table 3: Multi-goal analysis for Oneworld network growth

		Options for Partnership Growth			
		(A1) Traditional	(A2) LCCs	(A3) SCCs	(A4) Mergers
Goals	(G1) Maximize network size	Low-Medium 2	Medium-High 4	Medium-High 4	High 5
	(G2) Improved quality of service	Medium-High 4	Low - Medium 2	High 4	Medium 3
	(G3) Minimize partner conflict	Medium-High 4	High 5	Low 1	Medium-High 4
	(G4) Ability to implement quickly	High 5	Medium 3	Low 1	Low 1
Sum of Utilities		15	14	10	13

Source: Author

The following section details the rationale for the cumulative scores that have been assigned to each option for increasing Oneworld’s partnership opportunities.

6.1.3.1 Expansion through traditional network airlines

The first option is to grow partnership opportunities through the recruitment of traditional network airlines. This strategy scores highly in improving quality service and in ability to implement partners quickly. Non-allied network airlines are the most natural fit for alliance membership. They tend to meet the profile for a standard partner. These airlines offer full service products that are in line with the requirements that Oneworld traditionally has sought in alliance partners. It is therefore likely that passengers on Oneworld flights would be satisfied with the services delivered.

These airlines would also be relatively easy to add to the alliance, given that they are used to having partnerships with other airlines and would already meet a majority of the Oneworld requirements for membership. Target airlines could include Malaysian, Hainan and Gulf Air. Each would fit well with Oneworld's positioning as the quality airline alliance.

However, the strategy ranks low in maximizing network size. The reason for this is there are simply too few network airline options remaining to sizably grow the Oneworld network. The fact is there are not a lot of traditional network airlines available to alliances in most regions (CAPA, July 2010). Even if Oneworld were successful in recruiting Malaysian, Hainan and Gulf Air, it would add only 35 million total passengers to the network on an annual basis (IATA report, 2009). As of January 2011, the Oneworld partner airlines combined to carry 36 billion passengers on an annual basis (source: oneworld.com). The addition of these three airlines would therefore grow the Oneworld network by only 10% annually. As will be demonstrated below, this is a relatively small figure compared to other options for expanding alliance partnership opportunities. The total utility generated for traditional network airlines is scored at 15. This strategy would rank much higher if there were a wider pool of candidates.

6.1.3.2 Expansion through LCCs

The second alternative is inviting LCCs to join the alliance. This option scores high in maximizing network size and minimizing partner conflict. This is due to the fact that there are a lot of potential LCC candidates that do not currently compete directly with existing Oneworld alliance members. LCCs tend to be regionally focused so do not compete on international routes, which is the focus of a majority of the Oneworld partner

route strategies. These airlines have also traditionally not been approached by alliances for membership. This is due to the fact that they do not fit the model of a traditional alliance partner.

The alternative business model adopted by LCCs is also the reason that this option scores poorly in improving quality of service. This low score results from the relatively stripped down products delivered by LCCs. For example, the lack of business and first class cabins on LCCs creates a service delivery gap for business travellers. These passengers would need to transfer from a full service flight, with business or first class seats, over to an LCC flight that offers only one cabin of service. This should be a concern for the Oneworld partners who are already experiencing difficulties in extracting service premiums from their interline flights (as discussed in Chapter 4).

However, concerns of quality of service may not be a legitimate reason to exclude this option. LCCs typically service domestic and regional routes that do not involve long flight durations. Customers are already used to flying on smaller airplanes with lower service levels when travelling on short routes. Many full service airlines have reduced their service offerings for flights within Europe and on domestic routes in the United States in an effort to cut costs. In many cases it could be argued that the products provided by LCCs are superior to the products offered by traditional network airlines on short or domestic flights (source: Author's experience). LCCs could therefore potentially fulfill the role of domestic and regional feeders for alliances moving forward, with minimal impact to customer satisfaction.

The option also scores relatively low in ability to implement quickly. This is again due to the alternative business model adopted by LCCs. The simple business models of

these airlines have not historically involved establishing interline partnerships with other airlines. This is a new phenomenon which introduces a level of complexity that LCCs previously did not participate in. However, a growing number of LCCs are beginning to focus on attracting business travellers and this is resulting in adjustments to their strategies. In a recent interview Greg Saretsky, Westjet's CEO, advised that the company has traditionally focused on leisure travellers but its future growth depends on attracting business travellers. The airline is therefore boosting routes in the Toronto-Ottawa-Montreal triangle (key business traveller routes), offering a rewards program and introducing more flexible fares. Westjet is also starting to establish partnership agreements. The airline recently sold their first ticket on American Airlines. Saretsky commented "We are beginning to capture traffic that we would have never seen in our own network. And all of that over time will add tens of millions of dollars" (**The Calgary Herald**, March 2011). This is precisely the benefit the Oneworld partners could bring to Westjet and other LCCs. The relationship with American Airlines could be extended to other Oneworld airlines that service Canada.

In addition to Westjet, several other LCCs that could benefit the Oneworld network are Jet Blue (Eastern United States), Jetstar (Australia/Asia) and GOL Airlines (Brazil). These airlines all provide products at the high end of the LCC model and would add significantly to the Oneworld network. Oneworld currently has network gaps in each of these countries and regions. The four airlines would add approximately 70 million passengers to the Oneworld network on an annual basis. This would increase annual Oneworld passengers by 21% annually. The total utility for LCCs has been scored at 14, largely do to significant potential they bring for maximizing network size.

6.1.3.3 Expansion through SCCs

Expansion of partnership opportunities through the recruitment of SCCs scores high in a number of areas. Emirates, Qatar Airways and Etihad Airlines fit the alliance model in terms of product delivery. The airlines offer excellent services that are in line with, or exceed, the products delivered by existing Oneworld members. These high quality products could significantly assist in improving quality of service. These airlines could also add significant volumes of passengers to the Oneworld network. For example, the addition of Emirates would add 25 million scheduled passengers to the Oneworld network on an annual basis (IATA report, 2009). This would be an increase of 7% in annual passengers for the Oneworld network through the addition of a single airline.

However, SCCs score poorly in minimizing conflict amongst Oneworld partner airlines. The SCCs have network strategies that would create significant overlap with core alliance partners. Due to their strategically located hubs (Dubai, Abu Dhabi, and Doha), each airline is positioned to provide direct service to cities on six different continents (Deutsche Bank report, p. 80). This would create dramatic overlap with core airlines within Oneworld, including British Airways and Cathay Pacific. As an example, these Oneworld members compete heavily with SCCs for traffic originating from the Indian subcontinent. British Airways and Cathay Pacific move these passengers through their respective hubs in London and Hong Kong. Emirates, Etihad and Qatar are competing for the same passenger base through their Middle Eastern hubs. This inter-alliance conflict would likely be very detrimental to existing members.

A second issue is an inability to implement alliance agreements with SCCs quickly. To date, these airlines have not expressed interest in joining the alliance groups.

The CEO of Emirates, Tim Clark, has publicly stated that the airline would not enter into any global alliance as they are harmful to competitiveness (alroya.com, October 2010).

The fact is that Emirates, Qatar and Etihad are neither interested in alliance membership nor a welcome partner. This results in low scores for both reducing member conflict and for ability to implement quickly. The total utility for SCCs is scored at 10.

6.1.3.4 Expansion through mergers and foreign direct investment

The final option to be considered is growth through mergers. This membership acquisition strategy could enable Oneworld to poach airlines from Star Alliance and Skyteam. Two examples of potential significant opportunities have recently been reported by various media outlets. These include an opportunity for foreign direct investment in China Eastern, based in Shanghai (Skyteam), and an opportunity for a Oneworld alliance member to merge with TAM Airlines, based in São Paulo (Star Alliance).

The prospect of engaging China Eastern with foreign direct investment has recently been raised in the press. Oneworld members, British Airways and Iberia, are currently in the process of merging. In creating their new operating structure, the two companies have established an umbrella organization called International Airlines Consolidation Group (IACG). Willie Walsh, the CEO of IACG, has stated that the new company is looking beyond synergies between British Airways and Iberia. He explained: “IACG is not about putting BA and Iberia together. It is about creating a platform to create a carrier of global scale” (Taylor, July 2010). The model enables airlines to maintain their individual brands under the umbrella group but to drive operational synergies through schedule alignment and other areas. The IACG group has earmarked

Asia as a key region for expansion once their own merger completes. Analysts view Chinese carriers as willing recipients of foreign investment. Specifically, Liu Shaoyong, the Chairman of China Eastern, has courted outside investment (eTurbo news, September 2010). This potentially opens the door for Oneworld to gain a partner in China, where the alliance is currently at a distinct disadvantage to its alliance rivals. China Eastern would add 45 million passengers to the Oneworld network annually, an increase of 13% in annual alliance passengers.

A second example is occurring in Latin America with the attempted merger between Chile's LAN Airlines Group and Brazil's TAM. This deal would create Latin America's biggest carrier, if cleared by regulators. The merger would have a large impact on the global alliances. LAN is a Oneworld partner, whereas TAM is a Star Alliance member. The alliance that successfully woos this merged company will have a commanding lead in the Latin America air travel market. Oscar Garcia, the Chair of Interflight Global, who regularly briefs analysts on the Latin American air transport market, believes it will be Oneworld that is successful. "Everything LAN today is, in large measure, thanks to Oneworld," said Garcia. "I really doubt they would go to Star. TAM is Star Alliance, but only since May 2010, but that is nothing compared to LAN's founding membership in Oneworld. Should it stay with Oneworld, then Oneworld will be the dominant alliance in Latin America" (CAPA article, November 2010). TAM would introduce 27 million passengers to the Oneworld network annually (IATA report, 2009), an increase of 8% in annual passenger traffic.

The strategy of partnership growth through mergers and foreign direct investment scores poorly in quickness to implement. As discussed in chapter 3, cross-border mergers

in the airline industry are complicated by regulatory restrictions on foreign ownership. The ability for Oneworld members to utilize this strategy to increase partnership opportunities is therefore dependent on decisions by various regulatory bodies. It is positive news that aviation regulators appear to be relaxing industry restrictions. Over the past two decades, the introduction of Open Skies agreements, the creation of the EU's Single Aviation Market, more extensive granting of antitrust immunities and relaxation of foreign ownership restrictions have all reduced the restrictive regulations that have previously prevented cross-border mergers (Deutsche Bank report, p. 3). If these deregulation trends continue, this strategy offers significant potential for the Oneworld members to address the threats they face. The total utility for expanding partnership opportunities through the acquisition of China Eastern and TAM airlines through mergers is scored at 13 but would be significantly higher if trends continue and the regulatory environment continues to relax foreign ownership restrictions.

7: RECOMENDATIONS

Chapter 6 applied a multi-goal analysis to four strategic options for increasing partnership opportunities for the Oneworld airlines. These options are not mutually exclusive. In principle, they could all be taken at the same time. However, management resource constraints and desirability of potential members must be considered in prioritizing efforts. This chapter recommends that the Oneworld partners proceed with strategies to increase alliance membership through three options: 1) pursue non-allied traditional network airlines, 2) invite LCC partners and 3) take advantage of merger and foreign direct investment opportunities when they arise. It is not recommend that SCCs be pursued for alliance membership. Additionally, this chapter will reiterate that simply growing the alliance network is not enough to ensure value is driven through partnerships. Deep alliance relationships are required if value is to be maximized. It is therefore recommended that the Oneworld members complement their membership drive with a continued emphasis on gaining ATIs and establishing JB's on routes where immunities have been granted.

7.1 Increased Partnership Opportunities

The Oneworld partners must grow their alliance network if they are to reverse the trend of diminishing passenger numbers and ensure that partnership opportunities are not further reduced. They should do this by engaging in an aggressive membership recruitment drive. The immediate focus should be on actively pursuing any remaining non-allied traditional network airlines. This list should include Malaysian, Gulf Air and

Hainan. Given the small pool of non-allied traditional network airlines, a second immediate focus should be on recruiting non-traditional alliance airlines. This should include efforts to attract airlines that are at the upper-end of the LCC model. The recommended targets are Jet Blue, Westjet, Gol and Jetstar. It is recognized that these partners may impact the consistency of product service levels. However, these airlines will largely fulfill the role of domestic and regional feeder flights where passengers are already conditioned to not expect a full service offering.

An additional, longer term, membership expansion strategy should be to look for opportunities to poach network airlines from other alliances through mergers and foreign direct investment. China Eastern (Shanghai) and TAM Airlines (São Paulo) should be targeted. This strategy is admittedly complicated by the regulatory environment. Government hurdles exist but the regulatory landscape in many jurisdictions is changing. Governments are beginning to relax foreign ownership restrictions. If these trends continue, it will open a significant opportunity for the Oneworld partners to address the threats it faces, particularly in emerging markets like Brazil and China.

7.2 Deepen Alliance Partnerships through Joint Businesses

Any growth in alliance membership should be complemented by a focus on deepening alliance relationships. Deep levels of partnership are often required if maximum value is to be created and captured through alliance relationships. As Chapter 2 discussed, the ability for airlines to form deep partnerships is often dependent on ATI. ATI enables partner airlines to align flight schedules and integrate in ways that would otherwise be deemed as collusive. As was discussed in Chapter 5, Oneworld has been operating at a distinct disadvantage against the competition in terms of ATI approvals on

key routes. However, Oneworld has made progress in this area. Figure 8 provides an updated summary of immunities between alliances following the granting of Oneworld's ATIs on North Atlantic and Pacific routes in October 2010.

Figure 8: ATI between alliance partners post October 2010

		
 		
with	with	with
        	    	     

Source: Author

Oneworld must continue to work with government regulators in an effort to have ATI approved between partners on key routes. For example, American Airlines and Qantas Airways recently announced that an application will be submitted to the Australian Competition and Consumer Commission (ACCC) for immunity between the two partners on Transpacific routes (eTurbo News, March 2011). Oneworld should follow up the Transpacific filing by seeking to obtain ATI between Asia and the South Pacific and between Asia and Europe.

Additionally, Oneworld should continue to be aggressive in establishing JBs on routes where ATI has been granted. As was discussed in Chapter 2, JBs set the foundation for shared interests and deeper integration by creating an environment where

partner airlines share revenues on immunized routes. This reduces industry rivalry dramatically. Rather than competing against one another, alliance partners are encouraged to work together to maximize joint profits. The Oneworld partners should maximize the value of ATIs by establishing JB's wherever ATIs have been approved. An important example exists between American Airlines and LAN Airlines on routes from North America to Latin America. The two partners have enjoyed ATI on these routes for several years but have not created a JB (source: Author's experience). This leaves the two partners as competitors on these immunized routes and therefore does not take full advantage of the opportunity to remove rivalry.

It is recognized that this recommendation is very dependent on external influences. The granting of ATIs is reliant on decisions from various regulatory bodies. It is not simply a decision that can be made by the Oneworld partners. However, the member airlines can influence decision making. Resources can be dedicated to lobbying regulators who grant immunities. As an example, it took American Airlines and British Airways fifteen years and four applications to the US DOT and EU regulators to receive approval for ATI on their transatlantic routes (source: author's experience). This would not have happened had the two partners not been persistent and willing to devote resources to the effort. It is recommended that the Oneworld members continue efforts to gain ATI on key routes and proceed with establishing JB's between partners wherever ATI has been granted. This will ensure that the maximum value is created and captured through alliance partnerships.

8: CONCLUSION

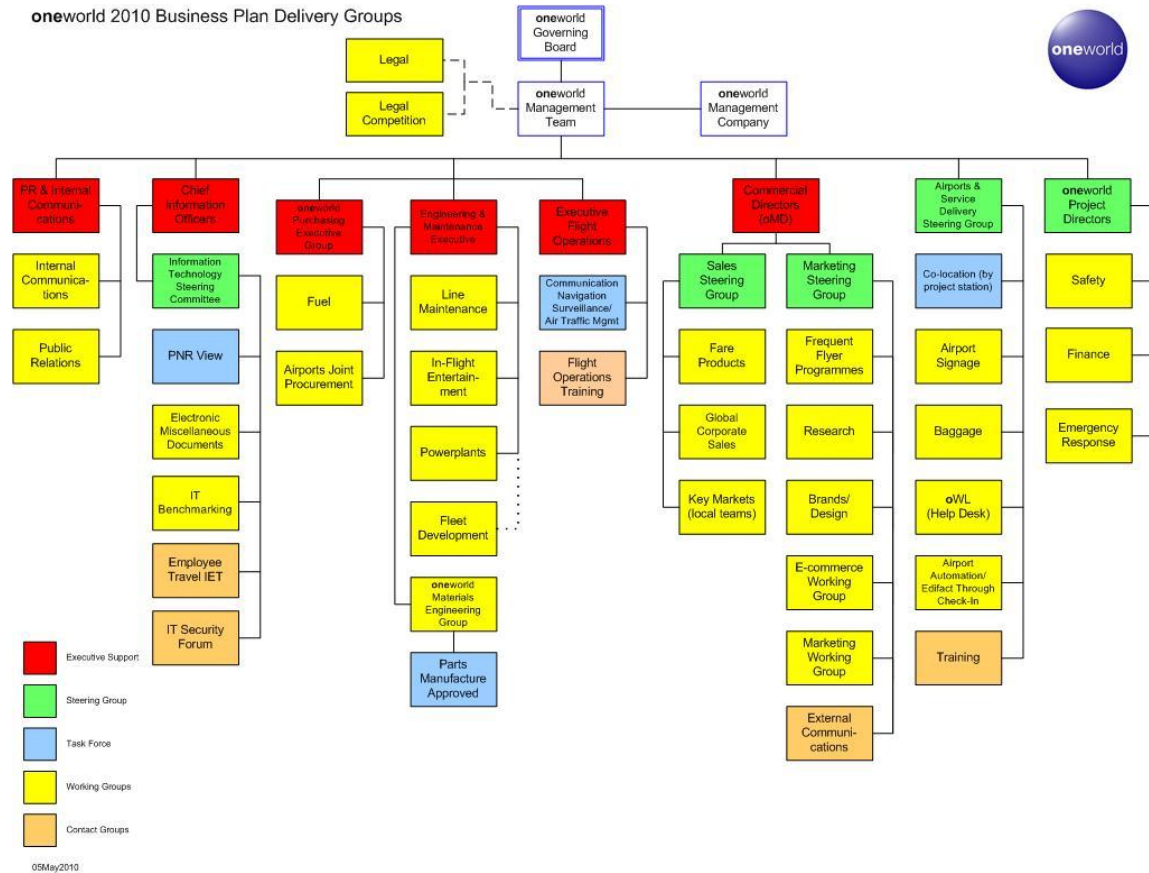
The alliance strategy employed by the Oneworld partners has led to strengths and weaknesses. Selective choice of partners has enabled the group to maintain a consistent product and service level. The downside of the strategy is the number of passengers flown by the Oneworld partners on an annual basis has fallen behind the competition and is decreasing on an annual basis, while the Star Alliance and Skyteam networks continue to grow annually. A smaller membership base is threatening to reduce opportunities for Oneworld members to establish valuable interline partnerships. Additionally, Oneworld is not well positioned in key growth regions for air travel. The alliance has no clear strategy for addressing network gaps in Asia and other emerging markets.

Oneworld should develop an aggressive, focussed strategy to network expansion. In the short term, this strategy should focus on recruiting any remaining non-allied network airlines. The short term strategy should also target airlines at the high end of the LCC spectrum. In the longer term, Oneworld should proactively target strategically important airlines through merger and foreign direct investment opportunities, two examples include China Eastern and TAM airlines. In addition, Oneworld should continue to deepen alliance relationships with existing members through the pursuit of ATI and the establishment of JBAs. The application by American Airlines and Qantas Airways for ATI between North America and Australia should be followed by similar applications between Asia and both Australia and Europe. The combination of a larger alliance network and deeper partner integration would deliver the primary objective of




alliance membership, which is enhanced profits through increased customer willingness to pay and reduced costs for member airlines.

APPENDICES




Appendix A



Appendix B

	 Emerald Status	 Sapphire Status	 Ruby Status
First Class priority check-in	✓		
Business Class priority check-in	✓	✓	✓
Priority standby and waitlisting	✓	✓	✓
Boarding at convenience	✓	✓	
Lounge access	✓	✓	
Pre-reserved preferential seating*	✓	✓	✓

*In accordance with the individual policy of the oneworld member airline operating the flight.

Airline	 Emerald	 Sapphire	 Ruby	Entry level No oneworld status
American Airlines	Executive Platinum	Platinum	Gold	AAdvantage
British Airways	Premier / Gold	Silver	Not applicable	Blue
Cathay Pacific	Invitation / Diamond	Gold	Silver	Green / Asia Miles
Finnair	Platinum VIP / Platinum	VIP Club / Gold	Silver	Finnair Plus
Iberia	Club Fiesta / Platinum	VIP Gold / Gold	Silver	Iberia Plus Clasica
Japan Airlines	JMB Diamond / JAL Global Club / Premier	JMB Sapphire	JMB Crystal	JAL Mileage Bank (JMB)
LAN	Comodoro	Premier Silver	Premium	LANPass
Malév	Duna Platinum	Duna Gold	Duna Silver	Duna Blune
Mexicana	MexicanaGO Conquer	MexicanaGO Discover	MexicanaGO Explore	MexicanaGO Welcome
Qantas	Chairman's Lounge / Platinum	Gold	Silver	Bronze
Royal Jordanian	Royal Plus Platinum	Royal Plus Gold	Royal Plus Silver	Royal Plus Blue
S7 Airlines	Details of how S7's frequent flyer programme will be included in the oneworld tiers will be announced nearer to its implementation into the alliance in 2010.			

Source: <http://www.Oneworld.com/ow/ffp/Oneworld-status>

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