DO THE GLOBAL ALLIANCES PROVIDE REAL BENEFITS FOR THE CONSUMER? AN EXAMINATION OF STAR ALLIANCE, ONEWORLD AND SKYTEAM

DEENA BLACKING

Senior Sophister

In light of current international aviation regulations and the commercial and economic realities facing airlines globally, Deena Blacking investigates the recent phenomenon of airline alliances. She focuses on the three major alliances - oneworld, SkyTeam and Star Alliance - and their impact on the global aviation market as well as their effect on consumers. The potential benefits to travellers are considered in addition to the potential problem of price collusion inherent in an imperfectly competitive market structure.

Introduction

In 2007, the global airline industry carried approximately 2.26 billion passengers (International Civil Aviation Organisation, 2007). For many countries, particularly island nations such as Ireland or Australia, access to air transport is vital for remaining connected to the rest of the world. Since the signing of the Convention on International Civil Aviation in Chicago in December 1944, there has been international recognition of the need to create conditions where ‘international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically’ (taken from the Preamble to the Convention). Today, with the advent of globalisation, air transport is an integral part of the world economy and society.

The first international airline alliance was formed in 1986 between Air Florida and British Island (Iatrou, 2007). Since then, many attempts at alliances have been made, some more successful than others. A primary catalyst for alliance formation was the liberalisation of the aviation industry, first in the United States in 1978 and followed by successive deregulation moves globally. In 1997, the creation of Star Alliance, and the formation of oneworld and SkyTeam in 1998 and 2000 respectively marked a divergence from previous alliance practice. These alliances took a strategic leap from traditional partnership methods - such as codesharing, bilateral agreements, and regional alliances - towards the creation of global networks and a common strategy. They achieved this by uniting several airlines from different regions to provide a global service of worldwide interconnected route networks (Doganis, 2007).

Today, these alliances generate about 55% of the world’s passenger traffic (Doganis, 2007), carrying over one billion passengers annually. The large presence of the global alliances in the aviation industry attracts continual attention from regulatory authorities (ICAO, 2007). On 3rd February 2009, the U.S. House of Representatives’ Committee on Transportation and Infrastructure introduced a bill ‘to study the effects airline alliances and anti-trust immunity have on consumers’, based on a concern that the initial ‘pro-consumer trend’ from global alliance formation had reversed.

This paper will consider the effects of global airline alliances on the consumer as follows: section one provides an overview of the global alliances and states the advertised benefits of their global service; section two explains why and how the alliances formed; section three compares the advertised benefits for customers with the evidence from twelve years of global alliances; and section four considers the case of competition and the price of air fares. Ultimately, this paper will produce a conclusive statement on whether or not the formation of global alliances is in the public interest or not.

An overview of the global alliances
‘The major benefit of global alliances to the airlines and consumers is an expanded and optimised route network. Through global alliances, passengers can, in theory, easily travel from one destination to another, anywhere in the world, with a ticket from one airline’ (Vasigh, 2008: 171).

- **Star Alliance**, founded in 1997, has twenty-one member airlines. It serves 912 airports in 159 countries and carries 499 million passengers annually
- **oneworld**, founded in 1998, has ten member airlines. It serves 673 airports in 134 countries and carries 328 million passengers annually
- **SkyTeam**, founded in 2000, has eleven member airlines and three associate airlines. It serves 905 airports in 169 countries and carries 462 million passengers annually.

Differing from the concept of alliances that operated prior to their formation, the global alliances expanded beyond purely commercial agreements towards the creation of strategic alliances and the use of a common brand (Doganis, 2007). Yet despite continual efforts to appear unique, the three global alliances have little basis for differentiation in the aviation market:

‘The three alliances essentially differ only in identity and membership – otherwise they can be seen to be pursuing the same objectives. From a product point of view there is no reason to prefer one alliance/airline over the other, since they are competing with similar tools and offering comparable products’ (Iatrou, 2007: 21).

An examination of each alliance’s advertised benefits and objectives exhibits this similarity. All three alliances present the following four points as key customer benefits of their service:
- They exist to serve the needs of the global traveller by providing worldwide access and benefits that are beyond the reach of any individual airline’s network;
- Faster transfer times;
- ‘Seamless connections’;
- Frequent Flyer Programmes (FFPs) and lounge access worldwide.

To what extent have these benefits been realised for customers? How do these gains to the consumer from global alliances compare to the gains to the airlines?

**Why did global alliances come into existence?**

Before we examine the benefits of the alliances, it is necessary to understand the conditions which permitted their formation; the factors which necessitated their formation; and what the airlines stood to gain from the alliances.

The developments in the aviation industry are best understood within the context of the industry’s environment. The environment which permitted the formation of the global alliances at the end of the twentieth century can be attributed largely to the twin external stimuli of globalisation and deregulation (Iatrou, 2007). The development of alliances was also necessitated by the drive to reduce costs, particularly during the early 1990s when the airline industry faced rising fuel costs, and in the North Atlantic markets in particular there were pressures on labour costs (Doganis, 2007). Finally, as liberalisation and insufficient traffic growth resulted in over-capacity and falling yields, the formation of alliances was seen as a way of maintaining market position and reducing competition. The reasons leading to the formation of the global alliances can therefore be seen as responses to these conditions.

**Responding to deregulation and globalisation:**

Since the first act of domestic deregulation of the US aviation industry in 1978, there has been a continually evolving trend towards the liberalisation of air transport. During the 1980s and early 1990s, the US, the European Community, and other governments worldwide were enabling more open and unrestricted markets. The deregulation of the industry enabled the emergence of new competitors, and a relaxation of pricing controls (Doganis, 2007). During these decades, the trend toward globalisation was creating a new need for global coverage and greater geographical spread. Despite deregulation, restrictive barriers to entry in international markets remained; ownership restrictions in nearly all bilateral agreements prevented cross-border mergers. The desire to respond to global needs for international route structures was thus unable to be satisfied. As a response, the main means by which airlines overcame these restrictions was through the formation of strategic alliances (Williams, 2002).
Responding to costs and uncertainty:
The aviation industry is cyclical in nature, which makes it vulnerable to the instabilities and uncertainties of the international economy (Iatrou, 2007). Unlike other service industries, it is a capital and labour-intensive business which is dependent on technology and subject to high operating costs. In the early 1990s, the airline industry was in a cyclical downturn and faced its most serious crisis of the twentieth century as revenue fell and costs spiralled. There was strong economic pressure towards the restructuring of most existing airline companies and a consolidation of the airline industry (Lawton, 2002). The development of alliances was therefore driven by the need to generate revenue, and to share the high fixed costs of major investments, especially in the advanced and expensive technologies of the aviation industry (Doganis, 2007)

By creating alliances, airlines were able to build global networks at relatively little extra cost, achieving economies of scale through resource pooling across operational areas such as sales and marketing, station and ground facilities, and maintenance and purchasing. In addition, membership of an alliance would buffer against the cyclical and unstable nature of the industry (Button, 1998).

Responding to demand and competition:
In the liberalised aviation industry, individual airlines struggled as they battled for market share and for limited capacity airport slots (Doganis, 2003). By forming alliances, three specific advantages could be gained to counter the problems of limited capacity and falling yields: access to new markets by tapping into a partner’s under-utilised route rights or slots; traffic feed into established gateways to increase load factors and to improve yield; and defence of current markets through seat capacity management and shared operations (Button, 1998). There is consensus in the industry that alliances produce substantial increases in traffic (Doganis, 2007; Button, 1998; Vasigh, 2008).

Dr. Michael Gremminger, from the European Commission Directorate General for Competition, believes that certain alliances seem to have been formed not only to achieve the necessary scale to compete globally, but also with the aim of limiting competition i.e. to control certain markets, to preside over slots at congested airports and to exploit traffic rights. The formation of airline alliances has made it possible for the partners to enjoy a kind of monopoly. Determining whether the lessening of competition is against the public interest would ‘depend if efficiency gains outweigh efforts by the airlines to extract supernormal profits’ (Button, 1998: 116). This can perhaps best be understood by considering not only the services and benefits provided by the global alliances, but also the price of the air fares.

What benefits do the global alliances create? Examining the evidence.

To assess whether the global alliances provide benefits to the global traveller, we examine the evidence from alliance performance to determine how well they provided the four key advertised customer benefits of their service.

Providing access to a global network:
It is generally recognised that alliances have enhanced global access. Data clearly shows scheduling frequencies are higher, that passenger traffic has increased, and there is a greater availability of destinations with on-line connections (Doganis, 2007). In a 2005 study of the global alliances, Iatrou and Skourias concluded that alliances lead to a significant increase in traffic on alliance routes (9.4% on average), enabled by the creation of effective hub-and-spoke systems offering worldwide coverage.

Faster transfer times:
Evidence shows that improvement in transfer times has been achieved (Doganis, 2007). For example, the Star Alliance strategy for achieving faster transfer times, Move Under One Roof, has reduced waiting times at Narita, Japan, by 50%. This reduction is achieved by grouping all the member airlines at the same terminal.

‘Seamless Connections’
The promise of ‘seamless connections’ is based on the alliances’ ability to provide a ‘one-stop check-in’ for passengers and their luggage no matter how many flight changes they need to make. This promise, however, is often not met as ‘passengers may not be fully informed that they have to change
planes’ (Sinha, 2001). oneworld claims the benefit of providing a fully e-ticketed service, but evidence has shown that communication breakdowns may still occur between the check-in at one airport and the transfer desk at another. Finally, while flying with an alliance can guarantee the connecting flight will wait in the case of a delay; this requirement to wait may cost other passengers on the connecting flight.

**Frequent Flyer Programmes (FFPs) with lounge access worldwide:**
None of the three alliances have created a single branded FFP, nor fully integrated the individual carrier FFPS. This lack of cohesion means that the privileges offered are quite standard, because they have to compromise between the offerings of all members (Iatrou, 2007). Nonetheless, for business class travellers, the global alliance’s combined FFPS with lounge access worldwide is an attractive loyalty scheme (Doganis, 2007).

Having considered the services and advertised benefits provided by the global alliances, the evidence is generally positive. Global alliances create benefits for the customer. However, given the concerns that entry into an alliance is not primarily to generate benefits for customers but to reduce competition, determining whether or not the alliance benefits the consumer depends also on the price of the air fares.

**Competition and air fares**

On 3rd February 2009, the U.S. House of Representatives’ Committee on Transportation and Infrastructure introduced a bill ‘to study the effects airline alliances and anti-trust immunity have on consumers’. Within the bill, concern was expressed that ‘fares in markets dominated by alliances have increased’. This was based on a 2007 article by James Reitzes and Dorothy Robyn. In the article, which analysed SkyTeam, it was shown that the initial ‘pro-consumer trend’ had been reversed. According to the article, the major factor for increased fares was the exercise of market power by alliances, reflecting a lack of sufficient inter-alliance competition.

When the formation of an alliance reduces operating costs, ideally this should transfer to customers by reflecting cost savings in lower fares (Doganis, 2007). Fare reductions are the most tangible way to demonstrate to antitrust authorities and the public that the alliance formation is in the public interest (Iatrou, 2007). While some studies have confirmed that passengers may benefit from lower fares when using one alliance rather than two non-partner airlines (Brueckner 1998; 2000), there is also evidence of fare increases (Sinha, 2001).

As with any other form of collusive action, the formation of alliances is likely to result in less competitive pressure (Williams, 1993). In consideration of the consequences for customers, the ultimate effect depends on the characteristics of the market where the airline alliance operates (Button, 1998). When alliances become very powerful at one or more hub airports, they may abuse that dominance to stifle new entrants and competition. They can also reduce competition on specific routes by creating effective monopolies (Doganis, 2007). A detailed economic study of air fares and market structures published in 2000 found evidence that economy, and to a lesser extent, business fares are higher on routes dominated by airline alliances (Gonenc and Nicoletti, 2000 in Doganis, 2007).

**Conclusion**

This paper aimed to determine the ultimate effect of global airline alliances on the consumer by considering the reasons for and factors enabling their formation; the strategies they choose to pursue; and the effects these have had on the consumer in terms of realised benefits and air fares. Based on the evidence presented in this paper, it appears that the formation of global alliances can provide certain benefits, such as increased traffic volumes, a greater availability of destinations, and the convenience of a ‘one-stop check-in’. Global alliances claim to provide greater global access and seamless connections through their effective use of hub-and-spoke systems. However, if they reduce competition and airfares increase as a result, it cannot be concluded that they provide overall benefits for the consumer. The growth of the low cost carrier model in recent years has demonstrated that consumers are increasingly indifferent to loyalty schemes and membership perks, and their perception of value is determined largely by the prices of air fares.
An important lesson from the emergence of global alliances is that the provision of complete economic freedom does not guarantee a strongly competitive environment (Williams, 1993). The future of aviation and the interests of the consumer appear to depend largely on the actions of legislators and regulators. Consumers will reap overall benefits from the global alliances only where there is adequate competition and market discipline.

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