3D Insight - Issue 22
June 2015

3D Insight

A Publication by AACO and Seabury Aviation & Aerospace

الإتحاد العربي للنقل الجوي
arab air carriers' organization

SEABURY

Alliances and partnerships – Matchmaking for success

In an industry where players are finding increasingly innovative ways to enter into partnerships, a one-size-fits-all alliance strategy may no longer be suitable. How have partnerships evolved, what different structures exist and what makes sense for AACO carriers?

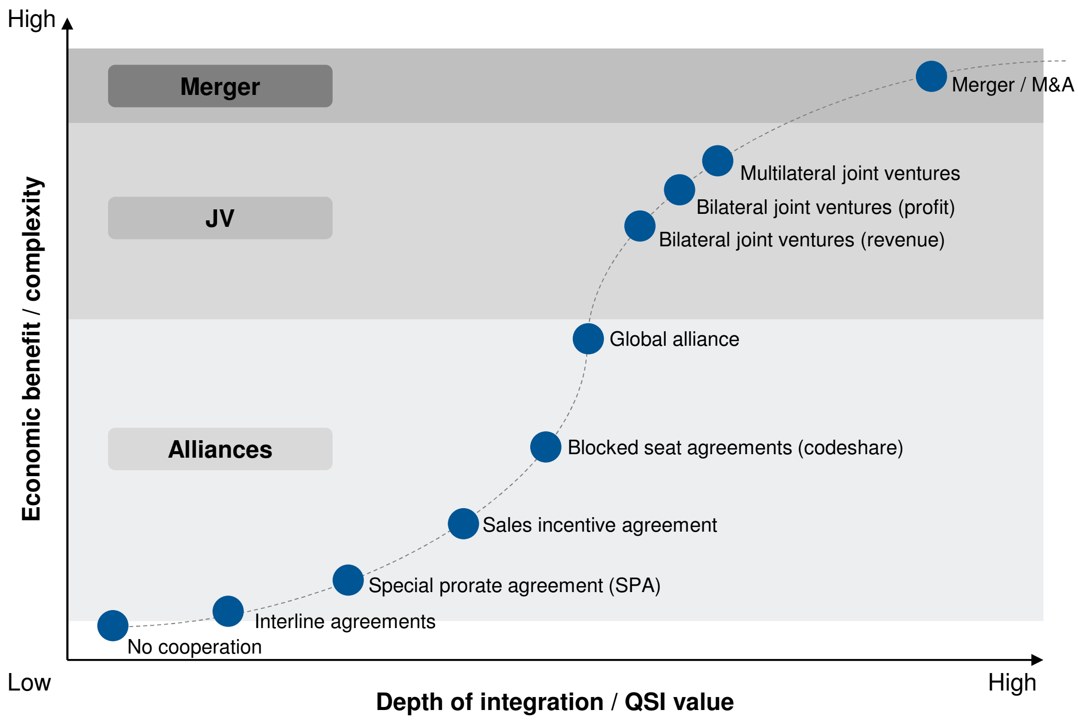
Context

In many respects, the airline industry has entered the "golden-age" of alliances, partnerships and airline groupings. In the past 15 years, the industry has faced two major downturns (in the early and late 2000's) which drove airlines to search for new and innovative ways to overcome very challenging operating conditions. Combined with changing regulatory landscapes, the "perfect storm" of conditions was created to drive the importance of partnerships as airlines became increasingly open to innovative ways in driving economies of scale, entering new markets and overcoming regulatory constraints, all with minimal capital investment.

The alliance spectrum

The types of alliances that exist today are many and varied and can be reflected on a spectrum of increasing economic benefit and complexity and depth of integration. Interline agreements reflect the lowest form of integration with cooperation only extending to allowing passengers to connect, with their baggage, between partner flights. Progression from interlines includes codeshare structures which are deeper commercial agreements that allow airlines to sell their code on partner airline metal and provide passengers with benefits including earning frequent flyer miles. Global alliances provide a structure for a network of codeshares between members as well as providing members with synergies on the cost side such as joint procurement or savings in shared facilities. Joint ventures reflect a more advanced form of partnership, in that revenues or profit are shared between partners on specific markets. Finally, the ultimate form of partnership is a merger, which may include the integration of one entity into another, often merging workforces, balance sheets and brands.

Figure 1: Airline partnership continuum

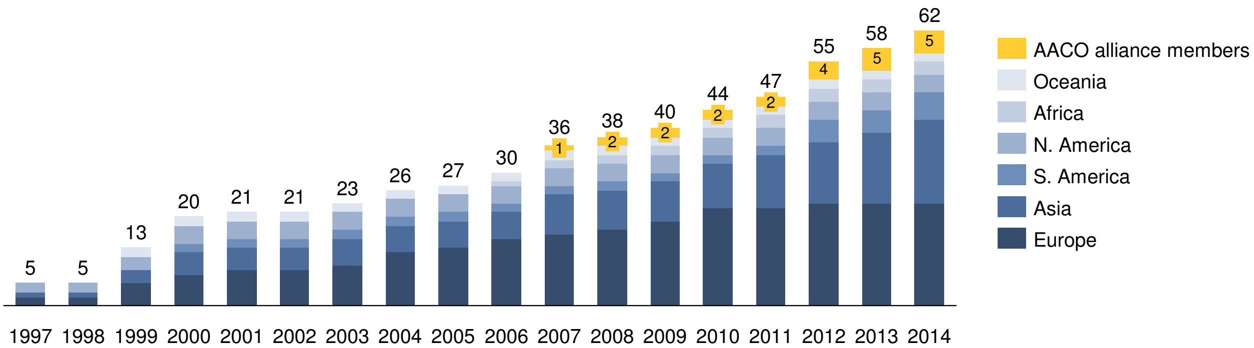


Among AACO carriers, partnerships have developed in three ways: bilateral codeshares (outside alliances), multilateral partnerships within an alliance and as a network of equity stakes. The development of joint ventures in the region has still been limited, but should be an area of consideration, given the growing prominence of joint ventures in other, more liberalised, regions.

Alliances and codeshares

While there are a wide variety of airline partnerships that exist outside the three global airline alliances (Star Alliance, **one**world and SkyTeam), the evolution of these three alliances over the past two decades is some measure of the increased appetite among airlines to enter into global partnerships. The number of airlines participating in one of the three global alliances has increased significantly since the inception of Star Alliance in 1997, followed by **one**world in 1999 and SkyTeam in 2000 (Figure 2). In recent years, the growth in membership has come mainly from airlines in developing markets in Asia and South America, while consolidation in Europe and North America has left fewer eligible new alliance members. Africa still has a vast number of relatively small carriers but only a few carriers have the scale to add value in an alliance. AACO carriers have shown some growth in alliance membership since the entry of Royal Jordanian into **one**world in 2007, with Egyptair, Middle Eastern Airlines (MEA), Saudia and Qatar Airways subsequently joining one of the major alliances.

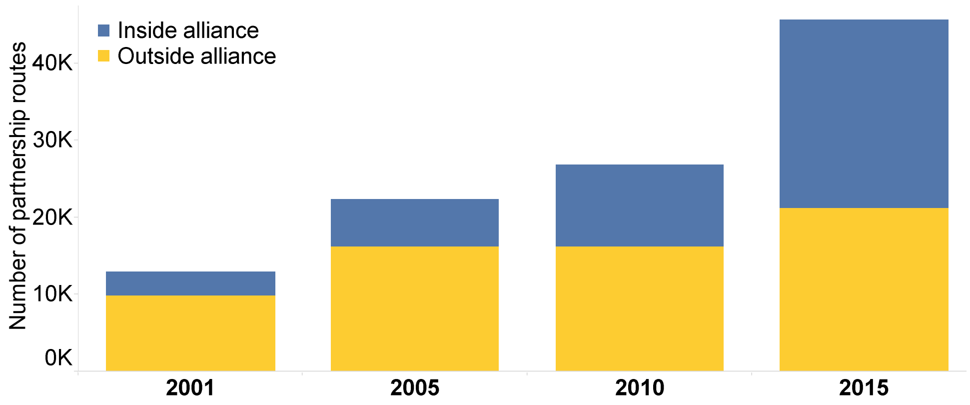
Figure 2: Alliance membership growth



Source: Alliance websites
Note: Tracks the joining dates of current members only

There is also an increasing prominence of bilateral codeshares outside alliances as a viable alternative to full membership. This has been driven particularly by the three Gulf carriers. Nevertheless, the growth of codeshare agreements across the industry since 2001 has largely been within the three global alliances. Since 2010, the majority of airline partnerships formed on routes have been within alliances, with only marginal growth outside the major alliances (Figure 3).

Figure 3: Airline partnership growth



Source: Diio Mi, codeshare summary

To date, the limited membership of AACO carriers within global alliances has meant the majority of partnerships formed have been on a bilateral basis. Since 2001, where only a handful of codeshares existed among AACO carriers outside of any alliance (Figure 4), some progress has been made with the number of codeshares formed within alliances. Again, this has been driven by MEA, Saudia, Royal Jordanian, Egyptair and Qatar Airways. As indicated by Figure 4 and Figure 5, much of the partnership activity has focused on growing East, connecting mature markets in the West with growing Asian markets. Most notable, however, is the growth of the partnerships of one AACO member in particular, Etihad, which has spearheaded the concept of building a network of bilateral partnerships and equity stakes as opposed to joining a major alliance.

Figure 4: AACO airline codeshares - 2001

Source: Diio Mi, codeshare summary
Note: Lines link two partner airlines' hub countries and do not indicate codeshare routes (i.e. SAA-Etihad codeshare, line connects SA with UAE)

Figure 5: AACO airline codeshares - 2015

Source: Diio Mi, codeshare summary; Airline websites
Note: Lines link two partner airlines' hub countries and do not indicate codeshare routes (i.e. SAA-Etihad codeshare, line connects SA with UAE)

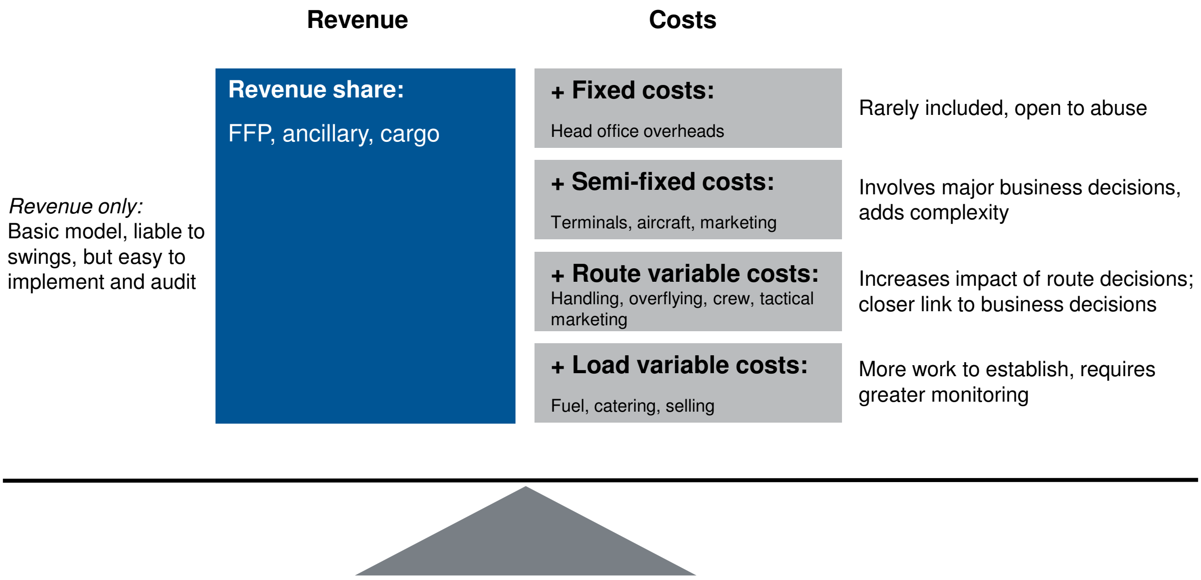
Etihad partners

Among the Middle East big three airlines, Etihad is by far the leader in the number of codeshares formed. Going beyond pure codeshare agreements, its network of partners (now under "Etihad partners"), includes a number of equity stakes, setting it apart from the typical global alliance. Beginning with a 29% in airberlin, the airline has since taken a stake in Air Seychelles (40%) and Alitalia (49%) with subsequent smaller stakes in Virgin Australia, Aer Lingus, Air Serbia and Jet Airways. These partnerships have provided Etihad with a fast track to growth, allowing it to keep pace with its Middle-Eastern rivals and gain the benefits from increased economies of scale. Coordinating and aligning partners to achieve cost and revenue synergies becomes easier with the control facilitated by an equity stake, something which is limited in traditional alliances. Activities such as joint aircraft procurement, aircraft-swaps and wetleasing are a few examples of how relationships based on equity partnerships can drive deeper cooperation and benefit. Nevertheless, even within alliances, there are platforms for deeper commercial cooperation, in the form of joint ventures, often among the alliance's most dominant carriers.

A future of joint ventures?

The natural progression for alliances, beyond their network of codeshares, and where the regulatory framework allows, is a deeper commercial agreement such as a joint venture, in which revenue and sometimes costs are shared. While joint ventures themselves are not new, the breadth and depth of these immunised unions is still developing. There are a wide variety of joint venture structures, and how suitable each of these is in a particular case will depend on the market's size, regulation and the size and complexity of the involved partners. Figure 6 represents the type of structures that can exist, from simple revenue sharing, to various mechanisms of cost sharing.

Figure 6: Joint venture structures



The most evolved joint ventures have been between European and U.S. carriers in the transatlantic market (Figure 7). This has been driven by the deregulation in that market which is one of the most liberalised in the world, since the signing of the European and U.S open skies agreement. The anti-trust immunity granted to such partnerships is based on the argument that they allow airlines to extend their networks to new markets, increasing competition and passing on benefits to passengers of improved schedules, lower fares, better connections and additional frequent flyer benefits. Moreover, the development of such joint ventures in each of the three major global alliances can be said to be boosting competition by keeping the alliances evenly balanced. The counter argument suggests that joint ventures are actually virtual, 'synthetic' mergers, allowing the same benefits as a merger but without the additional complexities or legal barriers. The sharing of information on route strategy, pricing, capacity and frequency can be seen as giving these airlines an unfair dominance over the market place. Moreover, alliance partners not included in the joint-venture but competing in the same markets are at a disadvantage, which could create intra-alliance rivalry.

Figure 7: Major airline joint ventures (1997 – 2014)

Source: Diio Mi
Note: Lines link two partner airlines' hub countries and do not indicate codeshare routes (i.e. SAA-Etihad codeshare, line connects SA with UAE)

More recent joint venture developments have looked towards Asia, including the joint ventures between Japan Air Lines, Finnair and British Airways and ANA and United. As with most of the early joint ventures across the Atlantic, these have occurred within an alliance. Nevertheless, there are some notable examples of joint ventures outside alliances, including the Qantas-Emirates tie-up, the joint venture viewed by many as a solution to Qantas's struggle on the kangaroo routes. This partnership is based on a "metal neutral" revenue pooling structure, where the carriers pool and share their revenue on trunk routes, on a net benefits basis. While both British Airways and Qantas remain in **one**world, this case is an indication of the importance of securing deeper commercial agreements if needed, which may supersede the need to remain loyal only to carriers within the same alliance.

Unlike pure codeshare agreements, the revenue and cost sharing implications of a joint venture mean they should be entered into carefully, and only after sufficient due diligence. Some of the key factors for evaluation include the baseline calculation for revenue and/or cost sharing, clear definitions of revenue and/or cost items to be included and excluded from the agreements, the treatment of fuel surcharges, the structure of prorate calculations, the geographic scope of the agreement and the governance structure and regulatory implications.

While it is clear joint ventures are starting to grow beyond the transatlantic market where they emerged, there are still very few markets and only a handful of airlines involved in such arrangements in other regions. Given the myriad of partnership opportunities that exist, joint ventures may not always make sense, nor may the regulatory environment be liberal enough in other regions to support such close cooperation. For AACO carriers, the concept may still be new, but it is something that might make sense in the future, particularly as these carriers grow, competition in the region strengthens and regulation loosens.

The way forward for AACO carriers

Large AACO carriers are well positioned to connect Africa, Europe and Asia while smaller carriers may be in a position to provide feed from lucrative, niche regional markets. In either case, AACO carriers can be attractive partners for carriers outside the region. The potential that could be unlocked for the larger AACO carriers already within a global alliance, through joint ventures with the larger alliance members, is something that may be worth investigating. As illustrated, this can also occur outside an alliance. The size, market presence, network fit and regulatory constraints of the potential partner should be the prime considerations of a potential partner, beyond their alliance membership status. Royal Air Maroc (RAM) and Qatar Airways have recently (May, 2015) signed a joint venture offering passengers enhanced links between Morocco and Qatar, adding a number of new onward destinations and increasing frequent flyer benefits. This is an example of the benefits that small or medium-sized carriers can gain from partnering with larger carriers. RAM's network provides Qatar Airways with access to West and Central Africa while Qatar's network offers RAM access to Asia. The latter is an example of benefits that medium-sized carriers like RAM can gain – access to long-haul markets that would be difficult to serve profitably with the airline's own metal. For larger carriers, the value that a joint venture can bring may make more sense than the value of an alliance, which may only support the development of additional codeshares. Within an alliance, it is typically the three or four largest carriers that exert the most influence and hold the most potential to unlock value in a joint venture. Consequently, these carriers will only find reciprocal benefit in other carriers of similar size. AACO carriers that are large enough to attract the interest for potential joint ventures with large European or Asian carriers seem to already be active in that area. For the majority of smaller AACO member airlines, however, significant value still lies in growing codeshares on a bilateral basis, something which joining a global alliance can accelerate. While it may be difficult for the large alliances to justify accepting very small carriers with limited market coverage, medium-sized carriers with access to niche markets in their region (such as RAM in West Africa or Royal Jordanian in the Levant) offer alliance member carriers access to these new markets. In turn these carriers benefit from passenger feed from major trunk routes, reaching regions that they could not serve profitably themselves.

Closing thoughts

There is no one-size-fits partnership solution. Growing a presence in new markets through partnerships, without the associated high investment in operating own metal, will always be an attractive growth strategy. For smaller carriers, access to a large number of codeshares from larger carriers in an alliance could represent significant value while for larger carriers, pursuing deeper profit sharing ventures can potentially unlock additional value. The value alliances bring is largely in the volume of partnerships that become available to a new joiner and therefore the resulting extended network coverage. Recent examples have shown, however, that deeper partnerships are developing outside alliances in specific markets, and for some carriers this may be a priority over alliance entry.

Whichever route an airline chooses, the decision should be based on sound commercial insights, an acute awareness of the regulatory complexities and a deep understanding of the overall impact on the carriers' networks. The complexities of such decisions should not be under-estimated and where possible, airlines should base decisions on robust analysis from industry-leading tools and specific expertise if necessary.

Statistics

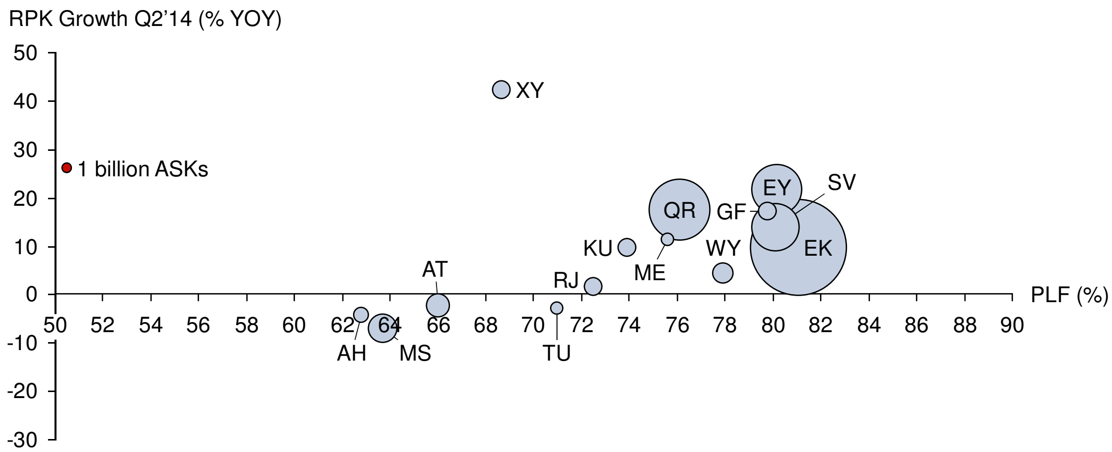
Executive Summary Statistics

Source: AACO
Note: Includes scheduled operations for AT, AH, EK, EY, GF, KU, ME, MS, QR, RJ, SV, TU, WY, XY

	Total	Q2 Year-on-Year Change	International	Q2 Year-on-Year Change	Domestic	Q2 Year-on-Year Change
No. of Pax	38,993,784	11.0%	33,278,474	11.2%	5,715,310	9.6%
Tonnes Cgo	1,179,388	5.6%	1,167,115	6.0%	12,273	-18.5%
RPKs (000)	129,754,331	11.9%	125,211,271	12.0%	4,543,060	9.7%
ASKs (000)	166,737,172	8.4%	161,153,519	8.4%	5,583,652	9.1%
Pax Load Factor	**77.82%**	**2.42%**	**77.70%**	**2.49%**	**81.4%**	**0.43%**
RTKs (000)	16,370,400	10.1%	16,000,464	10.3%	358,136	4.39%
ATKs (000)	24,725,350	7.1%	24,148,091	7.3%	553,368	0.0%
Weight Load Factor	**66.21%**	**1.80%**	**66.26%**	**1.77%**	**64.72%**	**2.72%**

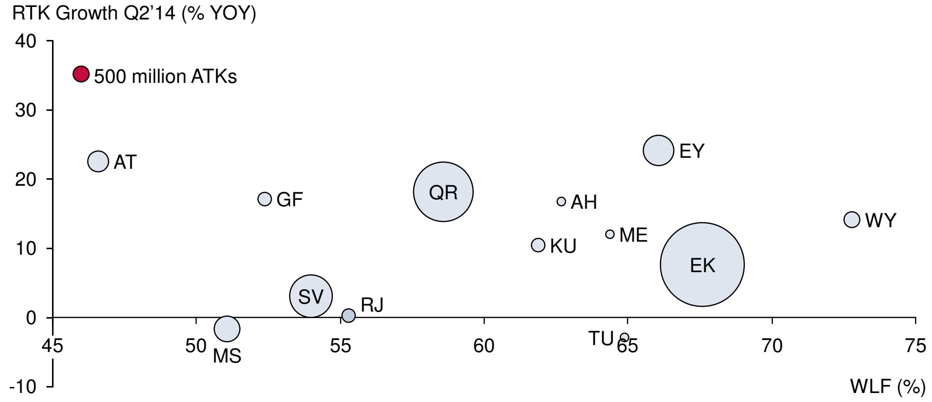
AACO members passenger size and growth

Fig 1 - Year-on-year revenue passenger kilometers (RPKs) growth versus passenger load factor (PLF). Bubble size indicates carrier size measured as available seat kilometers (ASKs)
Source: AACO



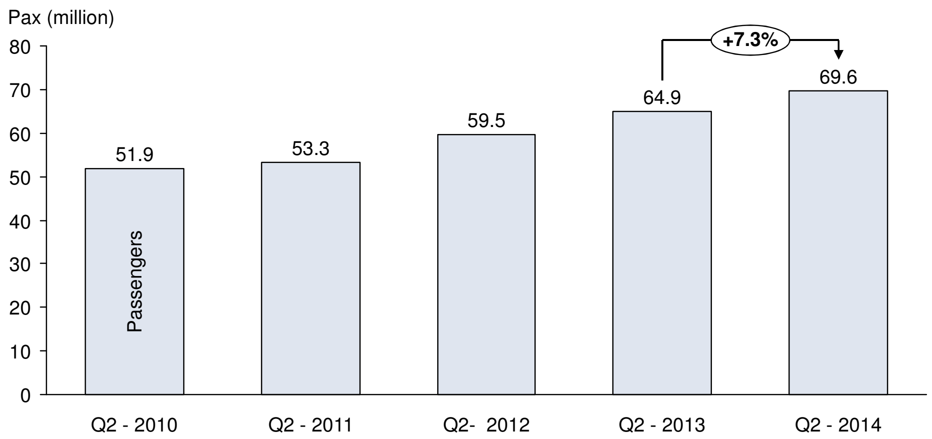
AACO members cargo size and growth

Fig 2 - Year-on-year revenue tonne kilometers (RTKs) growth versus weight load factor (WLF). Bubble size indicates carrier size measured as available tonnes kilometers (ATKs)
Source: AACO



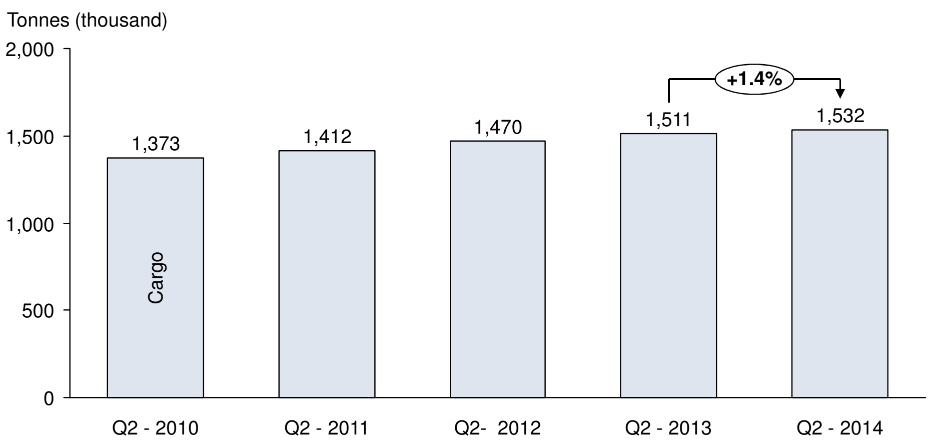
Arab passenger growth

Fig 3 - Historical trend of second quarter passenger transit volume in most Arab airports
Source: AACO, ACI



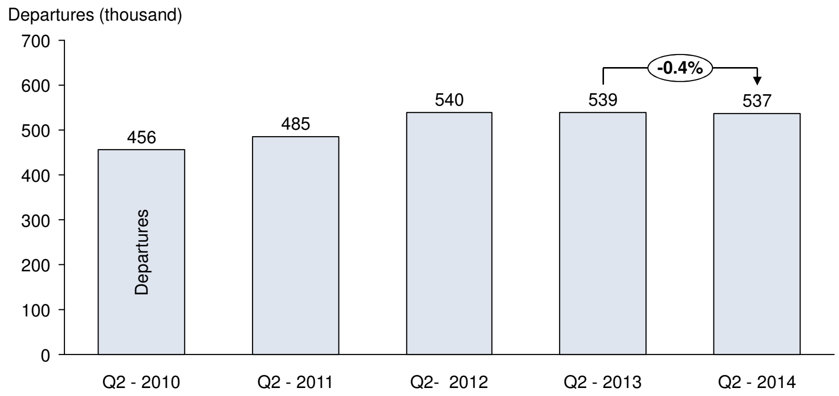
Arab cargo growth

Fig 4 - Historical trend of second quarter cargo transported in most Arab airports
Source: AACO, ACI



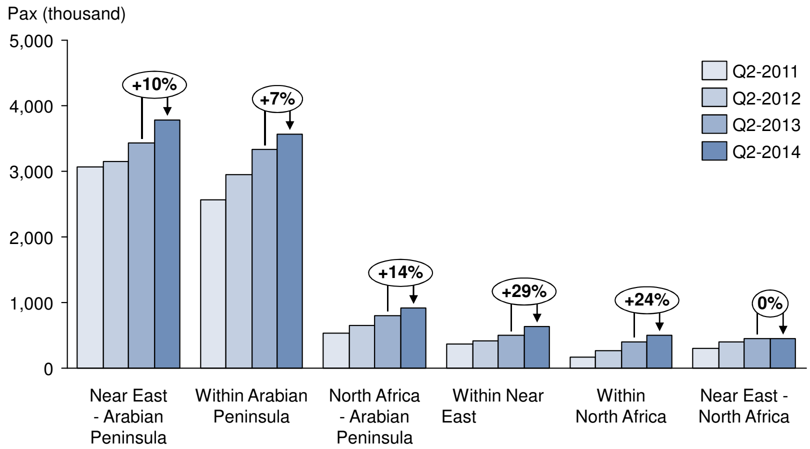
Arab departure growth

Fig 5 - Historical trend of second quarter traffic volume in most Arab airports
Source: AACO, ACI



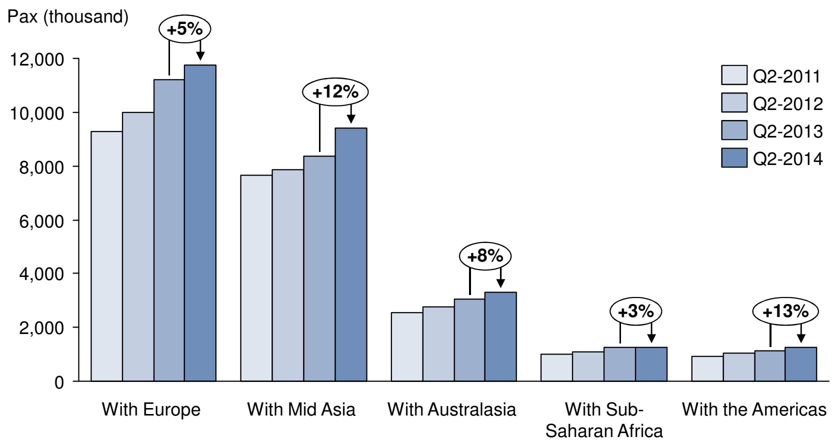
Intra-regional Arab market

Fig 6 – Second quarter international Arab market passenger numbers within the Arab World
Source: AACO, IATA



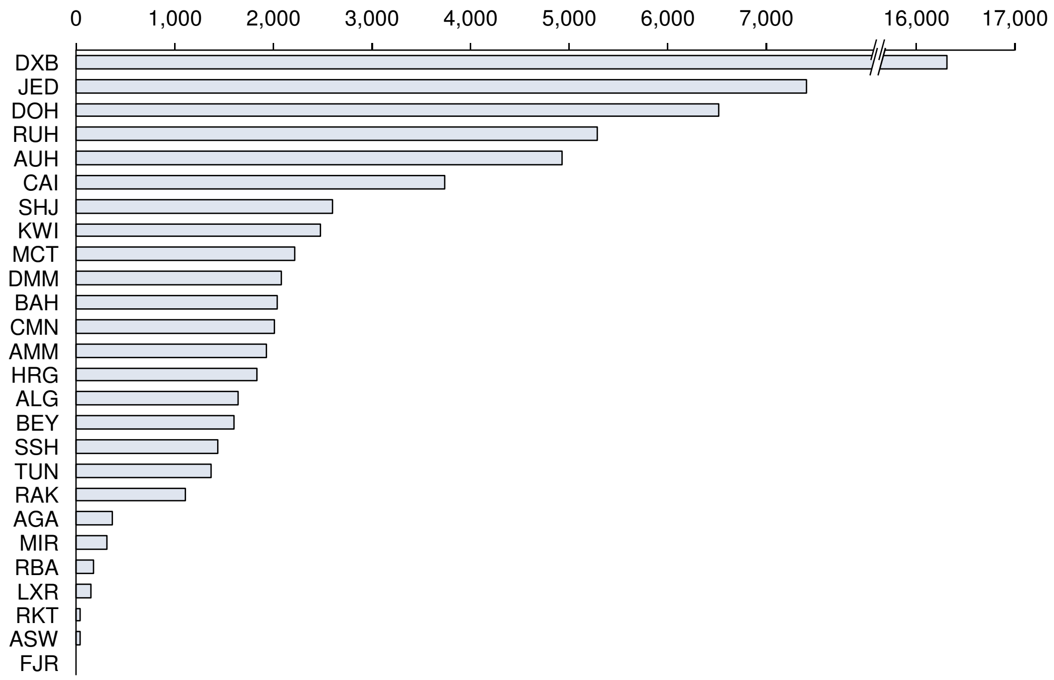
Inter-regional Arab market

Fig 7 - Second quarter Arab market passenger numbers to/from the Arab world
Source: AACO, IATA



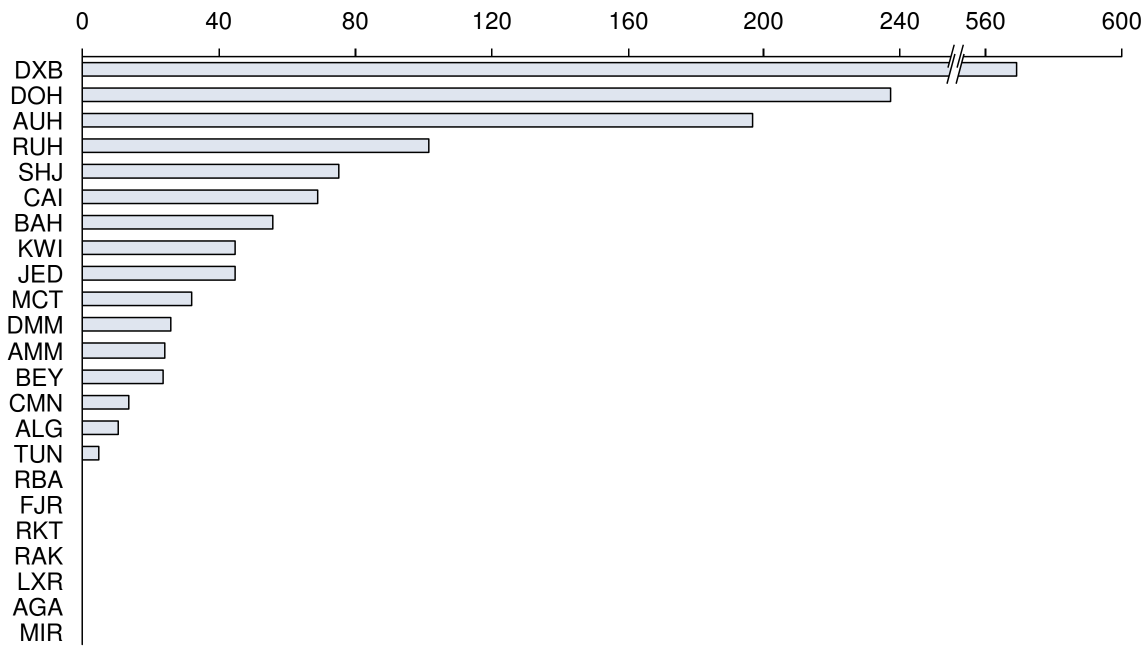
Airport passenger volume

Fig 8 - 2014 second quarter passenger volume in most Arab airports by port
Source: AACO, ACI



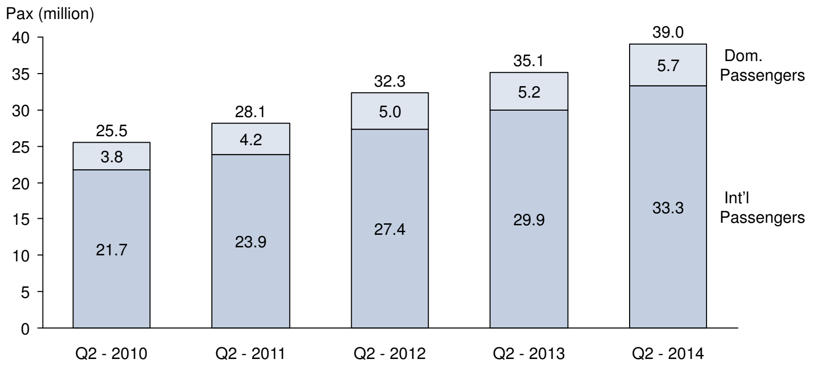
Airport cargo volume

Fig 9 – 2014 second quarter cargo volume in most Arab airports by port
Source: AACO, ACI



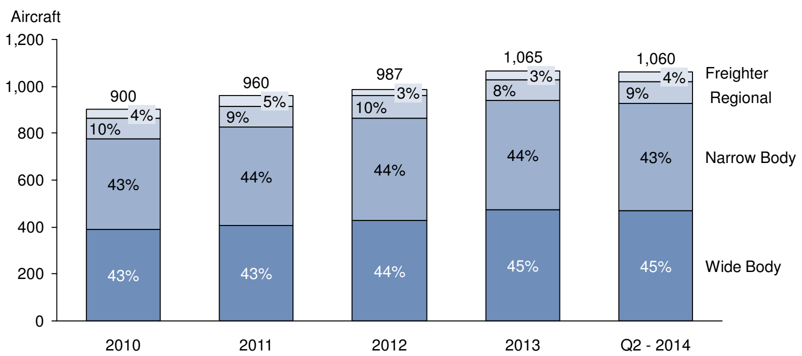
Domestic and international

Fig 10 - Second quarter AACO members' domestic/regional and international passenger volume historical trend
Note: Includes scheduled operations for AT, AH, EK, EY, GF, KU, ME, MS, QR, RJ, SV, TU, WY, XY
Source: AACO



Fleet growth

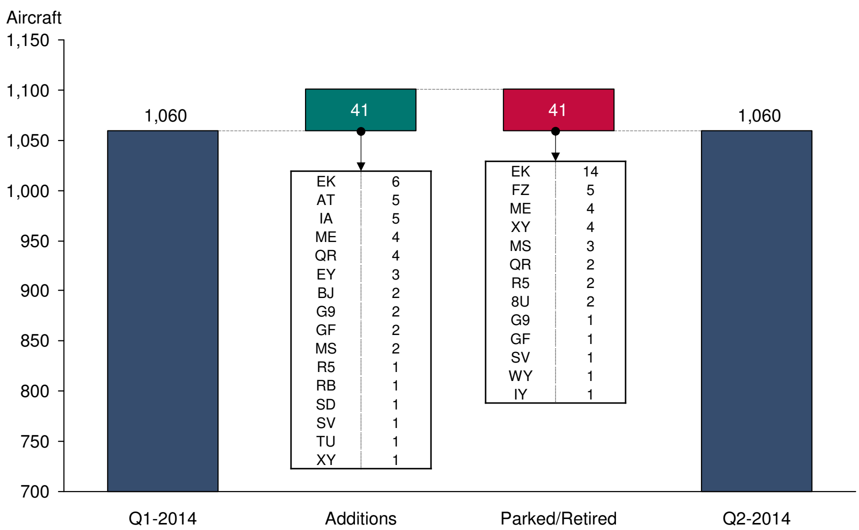
Fig 11 - AACO members combined fleet growth by aircraft type
Source: AACO, ACAS



	2010	2011	2012	2013	Q2 - 2014
Avg Seats	210	211	217	225	228
Avg Age (Yr)	7.1	7.1	7.0	7.0	7.1

Fleet changes this quarter

Fig 12 – Second quarter changes to the AACO fleet by carrier
Source: AACO, ACAS



Additions	
EK	6
AT	5
IA	5
ME	4
QR	4
EY	3
BJ	2
G9	2
GF	2
MS	2
R5	1
RB	1
SD	1
SV	1
TU	1
XY	1

Parked/Retired	
EK	14
FZ	5
ME	4
XY	4
MS	3
QR	2
R5	2
8U	2
G9	1
GF	1
SV	1
WY	1
IY	1

Seabury Aviation & Aerospace is the largest global advisory firm dedicated to commercial aviation and its related businesses. The experience of our 200+ professionals in strategy, operational cost reduction and restructuring is unparalleled.

Our unique team structure sets us apart from other advisors. We integrate the analytics of top-tier strategy consultants, the functional depth of technical experts, the financial acumen of top bankers and the experience of former senior executives.

As a result we hit the ground running and inspire trust in our clients by demonstrating expertise and understanding from the first day.

www.seaburygroup.com

الإتحاد العربي للنقل الجوي
arab air carriers' organization

SEABURY