

## **Chapter 1      Introduction**

The term 'alliance' refers to an agreement between airlines to cooperate in the provision or operation of some of their airline services. Alliances between airlines differ markedly. For example, they can incorporate arrangements such as coordination of frequent flyer programs, flight scheduling, baggage handling, catering, ground services, airport lounges, maintenance and in some cases, joint selling of seats and fare determination. Many alliances allow for code sharing whereby an airline is able to sell seats on its partner's airline rather than serve those destinations directly. Sometimes, alliances include equity holding arrangements, which may further strengthen the partnership between the airlines.

Alliances may be route-specific, involving the coordination of activities or flights between specific city pairs, or be on a country or regional basis. More complex alliances have sought to closely coordinate cost sharing and marketing initiatives over a larger geographical area such as between countries or regions. In some cases, the networks of international carriers have been so closely interlinked as to provide the appearance of a seemingly global network. Airlines have sought to cooperate in the provision of air services involving a large number of routes so as to strategically link their flight networks and provide globally interconnected services. Key examples are the alliances KLM/Northwest, British Airways/Qantas/USAir and United Airlines/Lufthansa.

There are a number of reasons why airlines may have an incentive to operate jointly through international alliances, for example:

- to increase their efficiency by improving their capacity utilisation or reducing their costs of operation;

- to enhance the marketability of their services to passengers by offering greater convenience, a larger network and greater frequency of flights;
- to overcome regulatory constraints on the ability of individual airlines to participate in a market such as capacity restrictions in the air service agreements, restrictions on ownership and equity holding across national borders, and restricted access to airport infrastructure; and
- to enhance their ability to exercise market power.

Examination of the impact of international airline alliances is complicated by the fact that each individual alliance or agreement is different. The impact is therefore likely to depend on a range of factors such as the extent to which the airlines coordinate their services, the geographical scope of the alliance, the nature of competition on routes on which airline partners operate and the extent to which any barriers to entry exist.

## **1.1 Problem Statement**

The interest of this study is in airline alliances' effect on airlines. The report will discuss on whether alliances can provide impact to the airlines and to compete in the international industry, thus increase their market share. The report will also discuss whether airline alliances can produce benefits for airlines and indirectly to the passengers.

## **1.2 Research Objective and Methodology**

This report seeks to address a number of issues:

- how do airline alliances compete in the international airline industry?

- under what circumstances are airline alliances likely to raise market power concerns?
- what evidence is there that alliances have produced benefits for airlines and passengers?

To answer some of these questions, this report examines a number of studies conducted overseas that quantify the impact of a few airlines alliances on, for example, airline revenues, traffic, market shares, services frequencies and fares.

### **1.3 The structure of the report;**

The remainder of this report is structured as follows:

Chapter 2 will discuss on what strategic alliances is, why airlines need partners to survive and how airlines being matched in order to form a strategic alliance. The chapter will also introduce the term airline alliance and examine the reasoning behind forming alliances. Lastly, this chapter will briefly explain the main forms of airline alliances and current alliance situation in the world.

Chapter 3 will discuss three main issues for this paper. In this chapter, the nature of international airline alliances and the growing trend for airlines to engage in alliances is examined. This chapter will also outline the circumstances under which international airline alliances might raise market power concerns. Lastly, the chapter will outline the various benefits derived by airlines from alliances.

Chapter 4 will provide some concluding remarks.