

Air Alliances: How to Benefit

Alliances can offer soft- and hard-dollar benefits for business travel programs when the conditions are right.



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In 1997, the world's first major air alliance, Star Alliance, was born, promising a new age of seamless and more efficient global travel. Ten years and two major competitors later (oneworld in 1999 and SkyTeam in 2000), the alliance business model has proved its worth. Allied partners now capture more than two-thirds of the global air market and their numbers continue to grow. Meanwhile, travelers enjoy improved service. But how much value do alliances bring to the managed travel program?

This article looks at how alliances have developed and answers the following questions:

- What advantages do alliances bring to companies?
- Are the benefits systematic?
- What are the prerequisites for negotiating effectively with alliances?
- How can companies maximize the benefits?

Synergies and service

Until recently, alliances have brought value mainly to airlines and to travelers.

For airlines, the value has come from synergies and important economies of scale in key areas such as route planning, yield management, maintenance, sales and marketing. In addition, airline partners have efficiently accessed destinations that would otherwise be closed to them because of costs and regulatory constraints.

This has led to a wider choice of city pairs and departures for travelers, combined with more frequent service and shorter connection times on many routes. At the same time, customers have benefited from more attractive frequent flyer programs, as well as access to a larger number of business lounges.

The benefits alliances can offer now extend to companies as well.

The three global alliances together account for 67 percent of global revenue passenger kilometers (RPKs) recorded by the International Air Transport Association (IATA).

Alliance	Star Alliance	oneworld	SkyTeam
Date of creation	May 1997	February 1999	June 2000
Membership	<ul style="list-style-type: none"> ▶ 20 main members including Air Canada, Austrian, Lufthansa, SAS Scandinavian Airlines, Singapore Airlines, Swiss, Thai, United Airlines and US Airways 	<ul style="list-style-type: none"> ▶ 10 main members including American Airlines, British Airways, Cathay Pacific, Finnair, Iberia and Qantas 	<ul style="list-style-type: none"> ▶ 10 main members including Air France-KLM, Alitalia, Continental Airlines, Delta Air Lines and Northwest Airlines
Coverage	<ul style="list-style-type: none"> ▶ 155 countries ▶ 855 destinations ▶ 16,545 daily departures 	<ul style="list-style-type: none"> ▶ 150 countries ▶ 700 destinations ▶ 9,000 daily departures 	<ul style="list-style-type: none"> ▶ 151 countries ▶ 744 destinations ▶ 14,711 daily departures
Network strengths	<ul style="list-style-type: none"> ▶ Europe, North America, Asia 	<ul style="list-style-type: none"> ▶ Smallest alliance but good global coverage 	<ul style="list-style-type: none"> ▶ North America, Europe
Network weaknesses	<ul style="list-style-type: none"> ▶ South America 	<ul style="list-style-type: none"> ▶ South America 	<ul style="list-style-type: none"> ▶ South America, Australia and New Zealand
Market share (% of total RPKs for IATA member airlines)	22.7%	21.2%	22.8%
Load factor	73.7%	76.2%	79.2%
Total revenue (US\$M)	119,286	90,713	92,842
Net profit (US\$M)	3,374	2,367	-7,734

Source: Star Alliance, SkyTeam, oneworld, IATA

Notes:

- Load factors, revenues and profits are calculated on the latest full-year figures for each member airline as of June 1, 2007.

- IATA member carriers accounted for 85 percent of total scheduled RPKs in 2005.

Benefits for companies

In the last few years, alliances have started to package their services for companies and propose formal alliance contracts. Star Alliance is leading the drive for corporate business with approximately 80 deals signed, compared to about 10 at SkyTeam and fewer than five at oneworld. Two main benefits are offered:

1. Soft-dollar benefits

- First, alliances **simplify the request for proposal (RFP) process** by providing a one-stop shop.
 - ▶ At the RFP stage, the potential client stipulates which carriers it would like to include, aiming to cover the majority of its consolidated air spend. The alliance

provides one main contact, which is often the airline considered most important for the client. Participating airlines then coordinate their response, either through a specific alliance management team (in the case of Star Alliance and oneworld) or through airline delegates (in the case of SkyTeam). This coordination can shorten the RFP process by three to five weeks.

- ▶ Alliances also coordinate the content of proposals. Alliance members frequently offer uniform contract terms and conditions. According to CWT observations, Star Alliance tends to set carrier-neutral targets—in other words, it enables the company to use several carriers per route to achieve volume thresholds. In addition, the airfare will be identical for all carriers on any given route. SkyTeam may also propose carrier-neutral targets, although this depends on the route and pricing among carriers may vary. oneworld, on the other hand, tends to propose only one carrier—and one price—per route.
- Once an agreement is signed, alliances can **streamline ongoing program management** by providing centralized fare loading and consolidated reporting. Quarterly performance reviews are also simplified when there is a single contact for all participating airlines.

2. Hard-dollar benefits

- Companies can realize **incremental savings** by leveraging overall volumes in their negotiations with alliances.
 - ▶ When companies consolidate their traffic data, they can identify larger volumes of existing business. Airlines tend to respond by offering lower prices to retain that business. They may also offer larger volume-based discounts in order to gain a larger market share, the aim being to “unseat” a carrier from outside the alliance.

On this basis, a major European bank negotiated an agreement with an alliance to cover flights from 10 countries. The company improved its up-front rebate slightly after presenting consolidated traffic data. At the same time, it secured a back-end rebate by committing to a volume of business across alliance members.

Are the benefits systematic?

Alliances do not always, however, offer the best deal. In fact, CWT estimates that concrete financial benefits are experienced by only half of all companies that sign up with alliances. In addition, companies may not receive proposals at all. There are several reasons why:

- **Alliances may not be able to bid jointly** for a company's business if they are not authorized to do so by regulators. Notably, the United States requires alliance partners to apply for, and obtain, immunity from anti-trust regulation, which enables

airlines to cooperate closely on their sales proposals (particularly with regard to pricing) without risking legal action.

- **Alliances may decide against making a proposal** if the company does not meet their criteria in terms of spend and geographical reach. Typically, alliances require significant spend on at least three member carriers or routes from three countries. They may also require companies to provide detailed point-of-sale data on a regular basis.
- **Specific airlines may choose not to participate** in the joint bid but make separate proposals outside the alliance. This typically occurs when alliance partners are in strong competition on a major route and want to secure market share through more robust individual bids.
- **Finally, companies may find that they do not have the right profile** to reap additional savings through an alliance contract and would be better off negotiating individual deals with airlines.



What are the prerequisites for negotiating effectively with alliances?

A company is most likely to benefit from an alliance deal when it has the following features:

- **A suitable traffic pattern.** Ideally, a company's main routes should match an alliance's network. Moreover, air spend should total at least US\$10 million since the benefits are likely to be greatest when high volumes can be spread over multiple alliance members.
- **A consolidated travel program.** Companies need to capture data and standardize travel policy and processes over the geographic scope covered by the alliance. Ideally, they would have the support of a single travel management company to do this.
- **A suitable sourcing strategy.** Alliance deals are most attractive when companies have a preferred partner sourcing strategy. They become less attractive when the travel program allows travelers to reserve tickets with alternative carriers on a best-buy basis.

How can companies maximize the benefits?

When companies have met these prerequisites, they can maximize the benefits by:

- **Carefully selecting airlines to include in alliance negotiations.** The carriers that offer the greatest savings potential may be those which currently account for the largest volumes and which have the strongest relationships with the company. It can be useful, however, to consider challenger airlines that tend to offer more aggressive prices.

- **Checking that the alliance is offering the most favorable rebates possible on a given route.** This is particularly important when the alliance proposes one rate per route across all members. For example, if airline A offers a 30 percent discount but airline B can offer only 25 percent, the alliance may wish to bring its rebate down to 25 percent. Companies should, therefore, compare the alliance offer with individual rates and consider negotiating independently with any member airline that can offer a better deal.
- **Ensuring strong support from country travel managers.** This is critical to ensure that the company can properly evaluate and compare the alliance proposal to conditions that could be obtained through separate negotiations with individual member airlines.
- **Reinforcing compliance with travel policy to ensure that market share targets are met.** Compliance can be promoted by negotiating additional benefits for travelers such as more frequent flyer points and access to allied members' business lounges, even for economy-class travelers.

In short, alliances represent one more way for travel managers to optimize their air spend, one of the eight key levers CWT has identified for effective travel management.¹ Simplified processes and greater savings are possible when companies have an appropriate profile and negotiate effectively with alliances. ■

¹ The eight levers of effective travel management are: provide the right services and assistance to travelers, and optimize transaction processing; tackle hotel spend in a disciplined and professional manner; continue to drive air and rail savings; optimize travel policy and improve program compliance; further consolidate travel programs; address security needs and corporate social responsibility; integrate meetings and events in the travel program to control and optimize the related spend; and develop executive dashboards and actionable performance measures.