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Mergers & Acquisitions:
innovative enough to survive?

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Presentation Outline

- Introduction
- Major airline mergers over last 10 years
- Obstacles to mergers
- Will American Airlines / US Air merger succeed?
- Potential merger benefits
- Mergers and innovation
- Summary of main points

Major European Mergers since 2000

Merging airlines	Merged entity	Year
easyJet/GoFly	easyJet	2003
Ryanair/Buzz	Ryanair	2003
Air France/KLM	Air France-KLM*	2004
Lufthansa/Swiss	Separate subsidiary	2005
Air Berlin/LTU	Air Berlin	2007
Lufthansa/bmi	Separate subsidiary	2009
Lufthansa/Austrian	Separate subsidiary	2009
Vueling/Clickair	Vueling	2009
British Airways/Iberia	IAG*	2011
IAG/Vueling	IAG*	2013

* separate operating companies

Major North American Mergers since 2000

Merging airlines	Merged entity	Year
American/TWA	American Airlines	2001
US Airways/America West	US Air	2005
Delta/Northwest	Delta Air Lines	2009
Republic/Frontier	Republic Airways	2009
United/Continental	United Airlines	2010
Southwest/AirTran	Southwest Airlines	2011
American/US Air	American Airlines	2013

Major South American Mergers since 2000

Merging airlines	Merged entity	Year
Asia/Pacific		
Air India/Indian Airlines	National Aviation Co	2007
Kingfisher/Air Deccan	Kingfisher	2008
China Eastern/Shanghai	Separate subsidiary	2009
South America		
Copa/AeroRepublica	Separate subsidiary	2005
Aviance/TACA	Aviance-TACA	2009
Lan Airlines/TAM	LATAM Airlines	2010
Gol/WebJet	Gol	2011

USA: AA/US merger: one too many?

- Result in four airlines carrying over 80% of US traffic
- Dominance on around 1,000 city pairs leading to possible fare increases
- Required to sell slots to competitors
- …. but smaller airports do not generate enough traffic to warrant competing airline service
- …. and previous mergers (eg Delta/Continental) allowed without slot sales
- ….. and previous allowed mergers had more competitive overlap than this one!

Merging international airlines

- Where acquiring airline is domiciled in a different country to target airline, targets international route and traffic rights my be challenged
- This because of need for airlines designated in Air Services Agreements to be ‘wholly owned and controlled’ by nationals of that country
- This is why many previous airline mergers were between airlines whose traffic was largely domestic or quasi-domestic (EU)
- However, traffic rights could have been compromised under recent EU mergers (eg Air France-KLM, Lufthansa with Swiss and Austrian, and BA/Iberia)
- This threat lessened by retaining separate operating companies and brands (eg Air France and KLM)

Motives for mergers

- Growth possibilities limited in current markets
- Need to expand network coverage
- Quick way of acquiring aircraft and/or facilities (eg slots)
- Obtain scale economies and synergy (overlap)
- Prevent competitor acquiring target airline

Merger benefits

- Greater network coverage leads to increased revenue opportunities (but many of these obtained through alliances)
- Synergy and economies of scale can lead to fare reductions
- Potential synergy clearly less with separate operating subsidiaries
- Synergy greater if overlap is large, but then more concessions required from competition authorities
- Few studies conclusive on revenue gains or unit cost reductions

Whose shareholders do better?

Bunnik (2012) Thesis* on Air France-KLM merger

- Positive impact on target airline share price in short-term (no significant impact on acquiring airline share price)
- No significant long-term impact on share price of merged airline (versus industry benchmark)
- No significant long-term impact found on share prices of 12 other of merged airlines

* 'Mergers and acquisitions in the airline industry', S. Bunnik, BSc Thesis, University of Amsterdam, Faculty of Economics and Business, August

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Merge or go bankrupt?

- **Lufthansa take control of bmi, SN Brussels and Austrian (in addition to Swiss)**
- **Bankruptcies focused on US and to lesser extent UK:**

Airlines: Is big beautiful?

- Airline size vs economies of scale, Merkert & Morrell, Transportation Research (48), 2012
- 66 airlines included in various DEA models
- Results suggest that optimal airline size is between 34 and 52 annual seat-km capacity
- Airlines with more than 200 billion seat-kms too large to operate efficiently

Scale efficiency results

Decreasing returns	Efficient	Increasing returns
American	Cathay Pacific	Korean
United	Ryanair	Air New Zealand
Delta	Virgin Atlantic	Air Berlin
Air France-KLM	JetBlue	Swiss
Southwest	easyJet	Etihad
Continental	Turkish	Gol
Lufthansa	Asiana	TAP Air Portugal
British Airways	Lan Chile	Air India
Japan Airlines		Finnair
Emirates		
Singapore Airlines		
Qantas		

Note: Service quality not evaluated, and technically inefficient airlines can be scale efficient.

Innovation and size

- **Amazon, Facebook, Twitter, Skype …..**

  Small start-ups, perhaps later acquired by telecoms or IT giants such as Microsoft

- Large companies' research departments may produce good ideas but these are brought to market by others (eg IBM, Xerox ….)

What about airline innovation?

Cathay Pacific business class seats

Airline Innovations

- First business class/cabin
- First lie flat seat in club class
- First airline to introduce FFP
- First all website booking
- First check-in kiosk
- First shower in aircraft
- First female only toilets on aircraft
- First airline to drive first class passengers to aircraft in a Porsche?

Airline Innovations

First business class/cabin	PanAm, Qantas?
First lie flat seat in club class	British Airways
First airline to introduce FFP	United
First all website booking	LCC?
First check-in kiosk	Air Canada?
First shower in aircraft	Emirates/Airbus
First female only toilets on aircraft	Korean
First airline to drive first class passenger to aircraft in a Porsche	Lufthansa

But overall winner for LCC concept: Southwest?

Ten most innovative airlines?

1. Korean Air
2. British Airways
3. Delta Air Lines
4. KLM
5. TAM (Brazil)
6. Qatar Airways
7. Virgin America
8. airBaltic
9. AirAsia
10. ANA (Japan)

Negative factors for innovation by large airlines

- Lack of international standards in some areas
- Need to introduce across the network
- Airport:

  Terminals not owned/leased by airline and thus need to agree change with airport management and other airlines
- Air Traffic Control/Management:

  Government owned and operated, too many centres, change needs to be co-ordinated across system, restrictive practices

Trade unions?

Summary of Main Points

- So far mergers restricted to between airlines within country or group of countries
- Can save airline from bankruptcy
- Greater the synergy and revenue benefits the more likely authorities will require some redress
- Some mergers motivated by need to prevent others acquiring airline (Lufthansa/SN Brussels?)
- Scale economies only available up to a point
- Innovation possible from larger airlines, but more radical change from smaller or start-up airlines