

## Let's talk about IT: Can partnerships and alliances save airlines?

### Answers to open questions from the Online Conference "Let's talk about IT" on May 7, 2020

*Do you foresee changes in the role of low-cost carriers (LCC)? Will the market will be less separate than before?*

The LCC business model will likely be challenged during and in the immediate aftermath of the COVID-19 pandemic. It will be nigh impossible for LCCs to generate high loads and also ancillary revenues under the infection control measures (e.g. leaving the middle seat empty and not being able to sell food and drinks on board). This means LCCs will have to "chase yield" to break even and go in with higher headline fares. This goes against the core principles of the LCC business model. Yes, the market may be less separate in the short term because there will be only one market segment, enforced by the infection measures. People will have no choice in what type of service/product they choose. However, this may not apply in the long term and we should not underestimate the agility of the LCCs and their ability to innovate and adapt.

*In the aftermath of COVOD-19 and different from 2008, the competition of remaining and heavily indebted airlines will be more intense than ever; individual commercial pressure will be immense; obligation to state loan providers will be limiting. Where in this scenario is room and appetite to partnering with competitors and to accept compromises (in non JV partnerships)?*

In fact, there may be a growing resistance to compromise and partnership in some corners, as (now nationalized) carriers protect their own turf. However, let us not forget that airlines still need traffic to fill their flights and that accepting compromise sometimes may be the way to achieve this. We may not initially see an increase in codeshare partnerships, but we may see an increased desire to interline traffic and take advantage of SPAs.

*If number of frequencies on direct services will be going down, will the travelling via hubs not be growing instead?*

This depends on how low the frequency is. Anything less than a daily frequency will always result in a spill to connecting services on the days when direct service doesn't operate. In addition, it depends on whether direct services are able to satisfy the unconstrained demand. The most interesting part of this question is whether we will see significant (and long lasting) change in passenger preferences. People may not be willing to connect at the airports and flights where they have to mix with people from

countries with higher infections rates. The question also remains if this mixing will be allowed in a short term.

*As domestic or intra-regional markets are expected to ramp-up earlier, what can FSCs with heavy focus on long-haul operation do to support their bottom line? Will we see some new form of FSC/LCC partnerships?*

The described situation is most applicable to 6th freedom carriers with no domestic/intra-regional markets. This will indeed be a challenge for them, as in a short term we are unlikely to see significant traffic flowing through long haul hubs. What we may see as a result, is some of these carriers (provided that they have money to do so, or an investor backing them), buying into/starting domestic airlines in other countries. Especially desirable will be markets where there is a gap due to the recent bankruptcy and regulators are open to allowing foreign ownership.

*Will the partnership model change permanently or until things come back to normal?*

The current crisis will be a stress test for all forms of airline partnerships, from basic interlining partnerships all the way up to tightly integrated airline groups. In our very own opinion, we do not believe that the industry will come back to the normal that we were used to but to a “New Normal” that still remains to be shaped. If this for instance means fewer airlines in the sky with relaxed ownership, rules that allow for cross-border M&A’s, the partnership models we know today will likely be a thing of the past. Then again, it is too early to tell what the future holds but I think the chances are high that it will be very different.

*What kind of partnerships/alliances model will dominate? B2B (JV) driven (operational or technical backend process alignment), network and codeshare driven (complementing each other’s network reaches) or B2C, alliance-kind driven (product and service synch towards the customer) and why do you think so?*

We consider complementing networks a prerequisite for any lasting and successful partnership among airlines, weather it is bilateral or multilateral. We do not think that one particular form of partnership will dominate in future although, as briefly mentioned during the conference, we do believe that Joint Ventures are best equipped to weather the current crisis and the potential “New Normal” to come.

*If international flights are taking more to resume, and domestic flights will come back earlier, this will not benefit partnerships to increase the market coverage?*

This depends on whether there will be sufficient connectivity between domestic networks and international connections. This is not guaranteed. In addition, the question is whether we will have sufficient international travel demand. Current codeshare agreements will probably stay in place, but domestic network planners will probably not prioritize partnerships in their schedules.

*Don't you think the nationalization will be the trigger to decompose "airline groups" and existing partnerships?*

Yes, this is a real possibility. We are already seeing tensions, especially in airline groups where tensions already existed prior to the crisis. This is not only a risk for airline groups but for any deep partnership, where two airlines from two different countries are sharing revenue (and in some cases costs). The government bailing out their own airline will not be prepared to subsidize another country's airline by proxy, without receiving significant advantage in return.

*What is your prediction regarding the consolidations and M&As in relatively fragmented markets (Europe, Africa)?*

This will be driven by the level of distress airlines experience in respective regions and readiness of the investors to recapitalize them. In Europe, we are likely to see bankruptcies rather than M&As, with the exception of well-capitalized or nationalized airlines. Africa is a politically more complex case with fewer airlines and we are unlikely to see M&A wave there.

*Jan has said that partnerships will very likely profit from the crisis. Do you see a threat in the way governments help their airlines at the moment? We currently see it with KLM and AF that KLM is putting pressure on the Air France to cut jobs opposed to what the French government wants. The relationship between both airlines has not been the easiest anyways*

We strongly believe that the current crisis will stress test existing partnerships, bilateral and multilateral, and while some partnerships may come out stronger, others will fall victim to the COVID-19 pandemic. This is especially true for partnerships that already in pre-crisis times faced challenges such as mistrust or strategic non-alignment. The crisis will not only amplify these challenges but at the same time can serve as an "excuse" to end even long-standing relationships. Nevertheless, in the grand scheme of things, we do believe that partnerships as a whole will profit and that we will in the medium-term future see increased partnership activities. Potentially even tie-ups among players in the airline industry that in pre-crisis times were unthinkable.

*The risk to hub & spoke is an interesting suggestion. Might we see a "mesh" platform based on universal ticket acceptance, so travelers choose their own connection points?*

This is an interesting idea! The challenge may be the infrastructure to do this. This type of initiative could only be driven multilaterally by someone like IATA. This would definitely break some existing business models.

*Don't you think the relevance of alliance will go down further due to JVs' faster development?*

There is certainly the danger that the relevance of alliances such as Star Alliance or SkyTeam further diminishes but as said during the conference, we do see the current crisis as a once in an alliance-lifetime opportunity to radically reinvent Global Airline Alliances. In our opinion, Alliances and Joint Ventures can perfectly co-exist and are actually to some extent even symbiotic, at least when the Joint Venture carriers are part of the same Alliance. Joint Ventures are to the largest extent commercial agreements unnoticed by the customer while Alliances are customer facing and with their promises and benefits make partnerships tangible and beneficial to the customer.

*What do you think about changes in distribution channels? Will direct sales get more focus among passengers and the carriers?*

There has been a move towards direct channels for airlines to reduce dependency on 3<sup>rd</sup> parties for a while now. Moving forward airlines will continue to find ways to reduce distribution costs and gain more control of the sale process via its own platform. In the post-pandemic world – it is more important than ever that cost bases are managed. Indirect channels will be more and more specialized towards niche markets, and where value-added services can be provided to passengers.

*As airlines might reduce their network to different extents, do you foresee airlines to shrink their portfolios of partners as well and to rely on the key big partners at large hubs to cope with staff & cost reductions ?*

If we see significant network changes in response to the current crisis that last for more than a few months, partnerships need to be reevaluated and remodeled to assess if they are still mutually beneficial under the “New Normal”. This, however, does not mean that partnership portfolios will shrink, the opposite might even be the case. Although overall demand will likely need several years to reach the 2019 levels, passengers will still demand to travel from “anywhere to anywhere”. In order to satisfy that demand partnerships will often be the only option.

*Is network still the main consideration for carriers to join an alliance? Are there any further values that airlines can gain from airline partnerships?*

The network will likely be lesser consideration, if there is no reduction in the number of city pairs served (which past suggests will be the case). Priority and value will be in filling the aircraft and generating network revenue contribution.

*1. In the short term, with governments paying airlines to fly and maintain a core operation in terms of skeleton flight networks, how will profit/revenue share JV partnerships be affected? 2. What is the potential for hub consolidation in Europe given the proximity of these major airports?*

For 1 please see the answers above. For 2: This will most likely happen in some form or another. Airlines (or airline groups) that operate multi-hub structure will seek to leverage the advantages of each hub but also consolidate where it makes sense to do so. This may turn to be an advantage; however, it again depends on whether there will be passenger preference for connectivity in the future.

*To which extent do you see airlines integrating for self-connecting/virtual interlining flights?*

As mentioned during the conference, history has shown that in a post-crisis scenario one can usually notice an increase in airline partnership activities. Virtual interlining and facilitated self-connection schemes represent innovative forms of airline partnerships that are fairly new in the industry but in our opinion are not yet mature. Nevertheless, we think the current crisis presents an enormous opportunity for innovative partnership mechanisms and schemes if they enable airlines to forge partnerships that with traditional means such as interlining or codesharing are technically not feasible and/or commercially not reasonable.

*Is the government helping Lufthansa financially like Air France?*

We only know what we read in the press.

*As new partnerships need to take place between airlines, do you think the appropriate infrastructure is available to accommodate for these new partnerships? If no, what types of new infrastructure is exactly needed, if necessary?*

If new partnerships are based on traditional mechanisms such as interlining or codesharing, the legacy infrastructure is available. Airlines that in the past have refrained from partnering need to still implement it though. If these new partnerships are, however, based on innovative partnerships mechanisms such as virtual interlining or airport facilitated inter-airline connectivity schemes, the infrastructure, meaning IT but also airport infrastructure, is somewhat available but then our opinion not yet fully matured. Again, as said earlier, the crisis could act as a catalyst for such innovative partnership mechanisms as airlines could be more willing to trial them especially since they are low risk and low cost. This could then give the much-needed boost to advance the required infrastructure and to create a real alternative to established partnership mechanisms in the airline industry.