Stronger together: airline partnerships as a means of surviving COVID-19, and thriving thereafter

As the aviation industry comes to terms with the havoc wrought by COVID-19, airlines are increasingly finding that there is strength in numbers and joining hands to forge a path forward is better than going it alone. Hence, among a range of actions to preserve cash and plot their future, they are turning to partnerships and cooperation agreements – even with erstwhile rivals.

This article is part of Lufthansa Consulting's ongoing series 'Shaping flexible organizations: how to deal with COVID-19-induced uncertainties.'

September 2020
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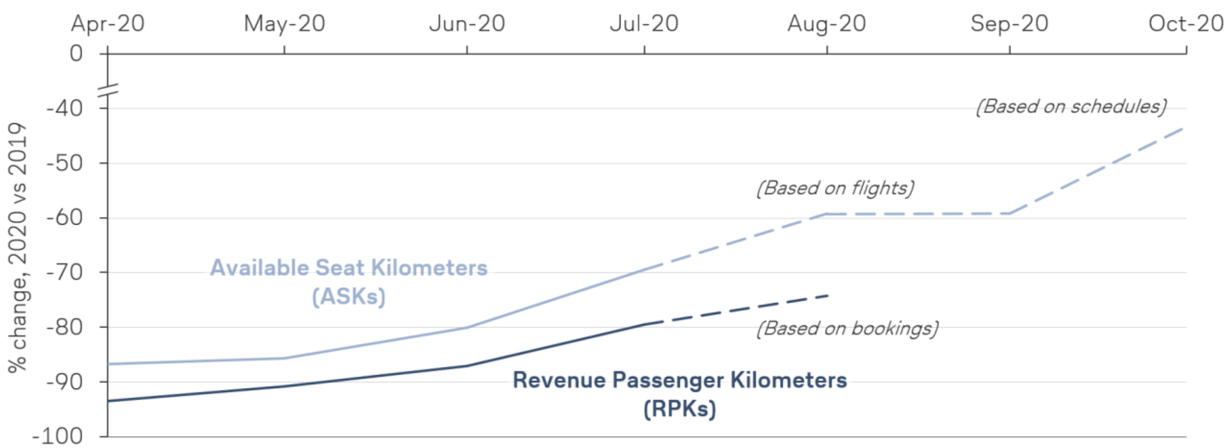
Aviation is still seeking a path to a post-COVID-19 future, over six months since the industry was upended. Through the northern summer, several key geographies have seen airlines return passenger capacity to the skies, only to have demand fall short of expectations. In fact, the global passenger load factor in July 2020 was nearly 30 percentage points lower than in 2019. The risk of further waves of Covid-19 outbreaks and the resulting travel restrictions is a further dampener on a struggling industry.

Figure 1: Rate of growth of capacity (ASKs) and demand (RPKs); demand clearly lags capacity



Source: IATA SRS Analyzer, DDS, IATA Economics
Note: Reflects situation as of 14 September 2020

Surviving the crisis and building a financially sustainable future, therefore, requires airlines to be flexible – about their scale, their ambition and their roles in the transport ecosystem. A flexible organization will constantly challenge its planning assumptions, quickly adapt and seek to build resilience to future adversity. This requires creativity and a willingness to evolve beyond historical market structures. Partnerships – even those between erstwhile rivals – are rapidly emerging as an avenue for airlines to jointly weather the storm.

Partnerships bring mutual benefit in a time of uncertainty and financial strain

Despite the unprecedented nature of the crisis, airlines are keen to offer the best possible connectivity for their customers, ideally operating a network as similar as possible to that pre-crisis. On the other hand, there is intense competition among airlines for a diminished customer pool resulting in a need for very measured reinstatement of capacity. Restarting an airline's historical network and frequency under current conditions would likely accelerate cash burn, leading to a fall in reserves (meager at many airlines) and jeopardize the airline as a whole.

Figure 2: Spectrum of airline partnership models

Source: Lufthansa Consulting

In a world struggling to balance the desire for expansion with the risk of overcapacity, airline partnerships can deliver an efficient solution. Higher load factors can be achieved by two (or more) cooperating airlines observing mutual capacity discipline. In some cases, both airlines could deepen market access and/or generate additional revenue streams through access to customers on each other's booking platforms. This effectively lowers commercial risk for the airlines in question, as is often an outcome of interline or codeshare relationships.

Airlines could, in addition, consider even deeper partnerships such as Joint Ventures, equity investments or mergers. This often entails but is not restricted to cooperation in sales, sourcing and operations, further lowering financial risk by leveraging economies of scale and sharing best practices. These are arguably more "permanent" moves, but may nevertheless be prudent for long term stability.

The industry was already inching towards partnerships and consolidation in recent years, and some of the transactions announced in recent months have their roots pre-pandemic. However, COVID-19 has served – and will continue to serve - to significantly accelerate this to provide a lifeline to airlines.

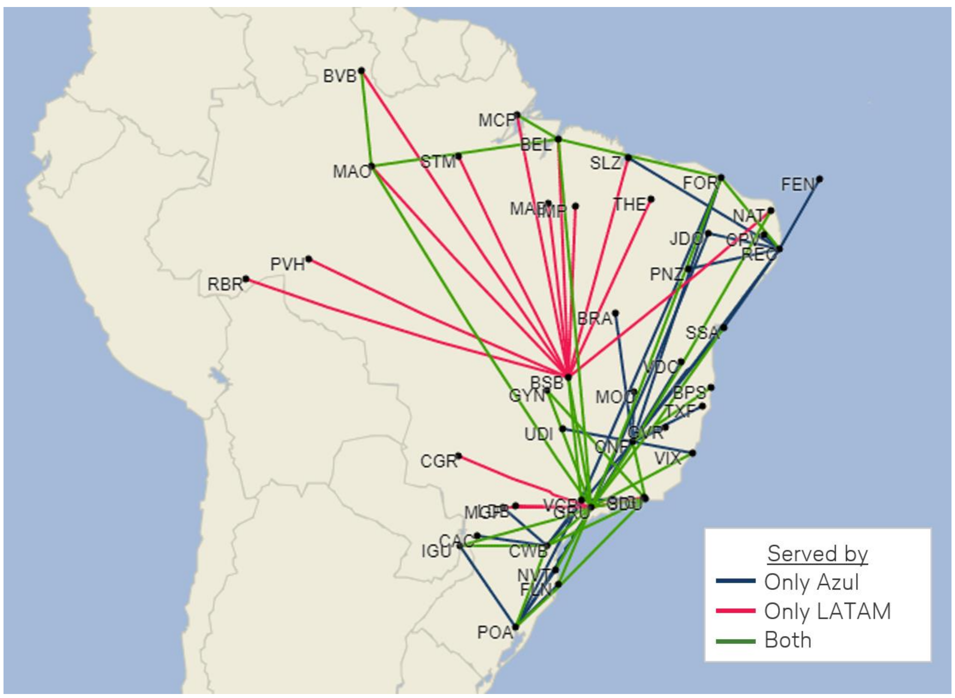
Three types of partnerships are to be expected

As airlines team up to tackle a COVID-19 impacted industry landscape, Lufthansa Consulting expects three primary types of partnerships will be forged and/or made deeper.

The first is that among **airlines operating in a competitive domestic space**. Growing domestic markets – such as those in Latin America and South Asia, for example – tend to be highly internecine with airlines engaging in cutthroat competition often driven by price.

In this context, the recently commenced cooperation between Azul and LATAM in Brazil is a great example. The two carriers have no history of partnerships and have generally been fierce competitors. Now, in the face of a market slump – traffic in April to June 2020 was a mere 10% that of 2019 - they have agreed to codeshare on 64 domestic routes to begin with. A full two-thirds of these routes are served by only one of the two airlines, significantly expanding the network reach of each while reducing competition on overlapping routes. And there may be more to come; the Chief Financial Officer of Azul is on record that the airline hasn't ruled out deeper forms of future cooperation including a Joint Venture or merger.

Figure 3: Scheduled codeshare routes, Azul and LATAM, June 2020 to March 2021



Source: IATA SRS Analyzer, Lufthansa Consulting

On the other side of the world, the South Korea's Fair Trade Commission granted low cost airline Jeju Air an exemption from antitrust regulations to allow its takeover of struggling competitor Eastar Jet, recognizing that the latter would not survive without the transaction. (Jeju Air has, however, pulled out of the deal given the prevailing uncertainty.)

The longer the crisis continues, the more the industry will see such moves, including within Single Aviation Markets such as those in Europe and Africa.

The second type of partnership is that between **international operators and regional or domestic carriers**. In previous articles, Lufthansa Consulting has highlighted the role of regional airlines in supporting the industry recovery, and the winning position that 'domestic champions' hold as traffic returns.

Take, for instance, the strategic partnership between American Airlines (AA) and JetBlue announced in mid-July. This offers significant benefits for both parties, building off their presence in Boston and New York. AA will enhance its domestic penetration by allowing its customers access to 130 new routes operated by JetBlue, while being able to focus more on its international operations. JetBlue, in turn has gained valuable access to a large international network. The reciprocal loyalty benefits and promises of a seamless experience make it a sweet deal for customers of both carriers.

On a smaller scale, the new codeshare between Air Serbia and Turkish Airlines covering 15 routes across four countries is also worth noting. It allows the smaller airline critical access to a wider network with a strong international partner, while allowing Turkish Airlines to reach smaller markets it might otherwise not have been able to serve profitably.

In essence, this allows each partner to play to their respective strengths, increasing their resilience to demand shocks and strengthening their joint financial and market position.

Finally, we will increasingly see **international carriers forging partnerships with other international carriers**. Intercontinental traffic has been hit particularly hard this year due to travel restrictions and customer concerns about health, safety and the disruptive nature of quarantines. Airlines are therefore joining hands to avoid competition and/or drive greater volumes on their respective networks.

In Asia, Malaysia Airlines and Japan Airlines launched an extensive "joint business partnership" in July, with commercial cooperation on flights between the two countries. While initially approved by regulators in December 2019, the sharp fall in traffic in 2020 and the ongoing financial troubles of Malaysia Airlines lent an urgency to initiating the partnership. The two airlines also leveraged their relationship to jointly drive discussions with their respective governments to ensure high safety standards and reopen traffic between the countries.

Finnair has doubled down on its long-term Asia growth strategy in spite of the ongoing pandemic, seeking to elevate its current codeshare agreement with Juneyao Airlines to a Joint Venture. This is likely aimed at not only cushioning short term effects of poor demand by enhancing mutual access to each others' core markets, but also positioning both airlines to recover faster than the competition as demand returns.

Agreements between international airlines typically have a long gestation period, but the pressures of a COVID-19 world are hastening the execution of these agreements. We will certainly see more such partnerships born from the crisis, including equity investments and mergers/acquisitions as the enterprise value of airline businesses falls. Airlines will also rely more heavily on existing alliance partners, leveraging joint scale for commercial and operational efficiency.

In short, airlines will find there is strength in unity as they ride out the rough years ahead

The end of the crisis is not yet in sight, and will depend on several factors that are not necessarily in the control of the aviation industry. Flexibility in one's business model and route network is, therefore, key and cooperation is essential. We are certain to see more announcements in this context in the coming months – from simple codeshares through to acquisitions – as airlines evaluate opportunities and strategies in the light of a disastrous 2020 and the prognosis for a slow recovery over the next three years.

Leaning on partners, whether through existing contracts and alliances or new agreements, will be highly relevant for the near future.

To learn more and discuss how your organization could benefit from Lufthansa Consulting's expertise on Airline Strategy and Crisis Recovery, please get in touch at ALcrisis-solutions@LHConsulting.com.

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