

# Globalization of airline industry management essay

[Environment](#), [Air](#)



In the globalization of airline industry many alliances have developed due to the environmental uncertainty that drove competitors into forming alliances. It has become an effective way for airlines to generate synergies with combined resources and expertise to sustain competitive advantage in the market and thereafter increase economic benefits thus maximizing profitability. Airline alliances are seen as a choice for strategic management intended to increase competitive capabilities in business competition (Matei, 2012).

In order to remain competitive it is important for the airline to incorporate corporate social responsibility as part of their strategy that helps to give airline recognition thus continues to increase profitability. However to shareholder extent, spending on CSR is seen as a cost and may not approve on high CSR expenses if the return is not high.

This report will discuss as to how Air France-KLM after merger was able to use its core competencies and dynamic capabilities to achieve and sustain in the airline industry. It will further discuss the importance of corporate social responsibility and how it brings an impact to the airline profitability.

## **2.0 Sustaining in global airline market through core competencies and dynamic capabilities**

A core competency of an organization is rather difficult for competitors to imitate and results into overall benefit for customers besides being reused by the organization (Gibbons-Wood & Lange, 2000). Core competencies and dynamic capabilities of organizations are viewed as an important strategic advantage which is being developed over a period of time (Zahra & Nielsen

2002). Similarly, dynamic capabilities of an organization allow it to use, integrate and reconfigure its external and internal competencies to deal with the external challenges (Chien, & Tsai, 2012).

Air France and KLM were two big companies in the airline industry and over a period of time the process of globalization and deregulation have increased much competitive constrain which causes both the airlines strategies to change in order to cope with the competition. The merger which took place in 2004 between Air France and KLM had created a global leader in the airline industry.

## **2. 1 Core Competencies**

Core Competencies of a company are specific set of skills which a company performs in order to deliver more value for its customers (Shaabani, Ahmadi, & Yazdani, 2012). After the merger, the combination resources of Air France-KLM had increased to meet the changing market demand. One of the tangible resources is on the great number of operating aircraft of 565 fleets whereas for British Airways is only 282 aircraft (British Airways Fact Book, 2007). This great number of fleets allows Air France-KLM to stay competitive in the airline industry. In addition Air France-KLM had gained access to a larger network to improve service quality and quantity where it operates in the largest and busiest routes in Europe with two major hubs in Paris and Amsterdam. By having multi hub system it provides flight transfer opportunities to ease customer inconveniences unlike for airlines without a hub may need to cancel direct flights and may be troublesome to customer to use a transfer ground (Air France-KLM, 2009). Competitor like British

Airways have two main hubs located only in London thus may not offer better routes options to customers (British Airways Fact Book, 2007). The increased of European market share particularly among business travelers for its long haul flights had increased the airline profitability (Cento, 2008).

Adapting to customer's demand and expectation such as low air fare and providing good service is one of the key challengers by the airline (Air France KLM, 2011) and without constant improvement will result in customer switching to other airlines that offer lower price and better route options and service. Indeed by having larger network, it brings greater benefits to the frequent flyer program offered to passengers as it will have more attractions and encouraged them to fly with the airline and thus increased the airline coverage without having to increase the route system. This lead to lower production cost and results in mass economies of network (Goel, n. d).

The key intangible resource is the airline able to integrate different employees' skills in a multi-cultural working environment to achieve new growth in the company. The management of the company truly recognizes the importance of culture and to minimize the differences by guaranteeing promotion without discrimination and retained the same logos, national identities and brands of two separate companies. It will thus create harmony, motivation and encourage creative and innovative solutions to problem due to wider social network among employees. However if cultural differences is not properly managed it will create conflict and miscommunication which will affect workplace motivation. Thus the awareness and prevention of cultural

differences undertaken by the management is truly one of the core competencies of Air France-KLM.

Besides being the leader in air transport offering passengers and cargo service, Air France-KLM is also one of the best maintenance and engineering department delivering an even stronger service. By sharing technical responsibilities has allowed insource of aircraft maintenance instead of outsourced to minimize cost and better aircraft operations. This helped to ground its fleets within shortest time possible for maintenance and be equipped for next schedule. The set of skills possessed by this department has given competitive advantage to utilize its strengths and become the leading airline in this new market (Vassolo & Anand, 2008). In contrast by outsourcing aircraft maintenance will result in higher cost and quality control may not be there.

## **2. 2 Dynamic capabilities**

Dynamic capabilities of an organization are determined by the ability as to how it can integrate its various competencies together to achieve and maximize the organization's profitability (Zheng, Zhang, & Du, 2011). It is different from its functional competencies which require the companies to be able to integrate the different competencies in a more organized framework to achieve the strategic objectives (Leonard-Barton, 1992). KLM was able to use its partnership links with American carriers and other global airline leaders in order to successfully challenge other airline carriers which started to follow the same merger strategy after the success of Air France and KLM.

Air France-KLM has been able to develop and maintain these core competencies due to its long existence in the market and the way it has placed itself within the industry. When the airline faced losses in 2010 due to intense competition from low cost carriers the company was quick to ward off its competition by forming shuttle service on Europe busiest airports and at a lower cost to maintain its core advantage (CAPA, 2011). This shows the airline capability to use its available resources to continue to gain profit and stay competent in the market.

By having network synergies the airline is able to reduce fare price to cater the different needs of customers and offered services which are aimed at different market niche. Moreover it further cultivates better asset utilization by eliminating routes which are unprofitable and non-essential. Further, as the world's leading airline in a competitive market it brings out the capabilities in terms of product placement either through direct operations or strategic alliances where branding had place itself in the markets. (Cui & Jiao 2011)

Prahalad and Hamel argued that the core competencies of a company allow development of core products which can be further used to create more products. (Prahalad & Hamel, 1990). The three main products of Air France-KLM are in the segments of passengers transport, cargo transport and maintenance services and the airline main synergy focus was technology using the latest modern fleets to ensure safety and fuel efficiency whereas for rival British Airways had failed to be given the credit for its latest innovation (British Airways Strategic Report, 2009). Through its deep focus

on these core products, Air France- KLM has been able to continue to innovate and further strengthen its core competencies.

It has also been argued that the leadership of a company should be able to form an independent view of how the future will hold and then develop competencies around it in order to achieve organization vision (Kippenberger, 1997). Despite of the merger disagreement, leaders from both Air France and KLM continued with the proposed merger as they believe of greater synergies especially the effect on fuel prices which is volatile and losses encountered due to decrease of travel demand between 2001 and 2003. Furthermore instead of employee lay off and cost cutting measure the group management had given eight year guarantees to stakeholders as a measure to avoid social threat and unnecessary restructuring. This clearly shows the priority given to keep stakeholders satisfied by retaining customers and employees in order to maximize shareholders return. As such the leadership of Air France-KLM can be seen as one of the core competencies of the firm which helped create a future to become more successful as a result of the merger (Nobre, 2011)

## **2. 3 Summary**

The merger between Air France and KLM has helped to achieve and sustain competitive advantage and become one of the successful companies in the airline industry. As a result, Air France-KLM got access to larger and extended network which allow serving and to retain existing customers as well as to penetrate into new markets while generating more profits for the company.

### **3. 0 Strategic alliances (SAs) and mergers and acquisitions (M&As) in the airline industry**

Strategic alliances as well as mergers and acquisitions have become one of the key growth strategies engaged by multinational organizations to ensure their sustainability in the market (Akgobek, 2012). This context applies the same for airline industry to sustain in a competitive market.

#### **3. 1. 1 Meaning and effectiveness of strategic alliances**

Strategic alliance can be defined as an arrangement between two companies to share resources in order to undertake a specific project that will have mutual benefit. In an airline industry strategic alliance is defined as joint arrangement between two carriers or competitors which involve in partnership in operations with the intention to improve competitiveness and thus strengthen airlines performance (Morrish & Hamilton, 2002). Evans (2001) further states that strategic alliance is an attractive tool especially in avoiding risk as both partners do not need to bear full risk and cost of the activities perform. Through alliance it able to help the airlines to develop a better operating system, expand the size of the target market and develop competitive strategies through increased financial base. Furthermore through combine resources airlines are able to incorporate shared airport facilities, integrate flight schedules, collaboration on frequent flyer programs and managing freight and marketing activities collectively (Evans, 2001, pp. 238). Strategic alliance is more effective in industries that move towards the same vision and product (Vedder, 2008).



According to Chanpayom (n. d) there are two types of alliances which are vertical or horizontal. Vertical alliance is a partnership between airline and suppliers whereas horizontal alliance is cooperation between airlines offering the same products and market and usually between airline competitors. Vertical alliance is able to gain more profit and effective if trust exists whereas horizontal alliance is able to combine resources and capabilities for market competition. A study was conducted by researcher and concluded that horizontal alliances brings significant contribution to company's productivity but less significant on profitability (Oum et al. 2004). However the effectiveness of airline alliances is measured by the airlines productivity and profitability hence it is important for an airline to consider the types of alliances based on company's core competencies. With global airline expansion and government policies many airlines need to find strategies to elevate the business higher in which alliance has brought advantage especially in the area of cost saving, new market expansion and increase in load factors.

### **3. 1. 2 Meaning and effectiveness of mergers and acquisitions**

Airline mergers and acquisitions are seen to be rising globally where it involves dissolution of both company's activities and form a single entity. In airline mergers it combines the transactions and forms a single and greater business. Whereas in acquisitions involve a corporate action by a company through which it buys most or all of the company's ownership so as to take control of the acquired firm (Aswathappa 2010, pp. 17). Being the industry that was greatly hit by competition many airlines join together to form a

stronger organization (Kumar, 2012) and expand its operation to further increase its market share. One of the benefits of merging is increased competitiveness of the organization formed due to increased financial resources, technical resources and human resources.

To ensure effectiveness of merger, workforce integration is important and both companies are advisable to learn the different cultural background to minimize differences to foster a closer relationship. The effect of cultural issue can be seen between Northwest and Delta airline in 2008 where due to labour matters the merger talks was disrupted (Chacko, 2011)

### **3. 1. 3 Summary**

As such SAs and M&A is effective in being able to bring competitive advantage to airlines as it able to utilize the integrated resources to achieve economies of scale and thus to increase shareholders profitability and market share. In addition cost reduction and obtaining good revenue is able to strengthen airline's merged financial situation and allow better competition in a highly competitive industry environment using combined resources.

### **3. 2 Strategic alliances and mergers and acquisitions in Air France-KLM**

The strategic alliances act as a vital means for Air France-KLM to implement cost strategy by making full use of their current resources. By establishing SAs and M&As in the airline industry has seen to be able to achieve competitive advantage that brings benefits to companies in the area of low cost leadership and product differentiation. Porter has identified two types of

competitive advantage a company is able to have which is low-cost leadership and product differentiation (Minarik, 2007). But this discussion is based only on low-cost leadership.

### **3. 2. 1 Profitability through low-cost leadership**

Low cost leadership strategies are the company's ability to deliver a product or service at a lower cost and obtain cost advantage over competitors which then further increases the market share (Bordes, 2009). The focus on low cost strategy requires a company to influence on the basis of cost advantage in the value chain activities. Through merger and with combined resources of Air France- KLM it helped to minimize the cost of production and maximize profit which allows competition on pricing strategy with other airlines. Reduction of cost helps an organization to prepare low cost leadership strategy (Financer World Wide, 2008).

In order to have a good market position the company needs to use the latest innovative technologies which will help in less usage of fuel because of highly volatile in fuel prices and limited in its availability. With constant fleet innovation using latest technology will improve its fuel efficiency and in the long run help to lower down the cost and increase the airline profit.

In terms of economic benefits, merger and alliances is able to integrate cost cutting strategy as well as merger synergies to increase passenger traffic thus raising overall operating profits. Furthermore to improve on flight schedule the airline had strategized by balancing their flight frequencies and operates on bigger aircraft size on routes with most flights. As such it

reduces unit cost and the same time maintains a good offer for passengers (AirFrance-KLM, 2010).

In terms of purchasing benefits, after the merger it increases their bargaining power especially on the purchasing of fleets as both Air France and KLM had different medium-haul fleet hence it gives more negotiating power to buy new aircraft from the two aircraft manufacturers to buy at lower cost (Spinetta, 2006). Besides that, the airline had restructured the maintenance and overhaul costs into a more cost effective resource allocation which able to enhance the work capacity at their facility and the same time decreases inventory costs.

### **3. 2. 2 Summary**

It can be certain that the merger between KLM and Air France has certainly enabled the group to increase its corporate profitability and global reach by a considerable extent through shared operation and effective coordination. As such maximizing profitability will not only benefit the airline as a whole, but also for the stakeholders which includes employees and customers.

### **4. 0 Organizational purpose and corporate profitability and responsibility**

In today's organizations besides setting vision, mission and objectives as the main purpose, achieving profitability, growth and maximize shareholder's value is seen as a common purpose of a company. In early studies, shareholder model was formed and states that managers and executives are the agents for the company and they have no authority to use money for social responsibility. In a multinational company the principal-agent

relationship exists between shareholder and manager where it allows manager to make decision on behalf of shareholders (Mcmenamin, 1999). As such shareholder would expect decisions made with their interest in mind such as to increase share price, lowering the risk level thus generate profitability. It is important to have a good corporate governance structure and business ethics which states the rules and responsibilities among the managers in decision making (Arjoon, n. d).

However profitability cannot be the sole driver but rather looking also at stakeholder's interest particularly the employees, suppliers, customers and communities. According to Arias & Patterson (2009) in stakeholder theory, the managers must know their responsibilities towards different stakeholders in the society and look beyond merely shareholders. Therefore to continue being competitive in the market it is important for organization to meet these demands at the shareholders expense by implementing corporate social responsibilities (CSR). Schermerhorn (2010) commented the commitments to corporate responsibility will double the outcome of financial performance and social impact where the performance of economic, social and environmental will be increased. However Longenecker, Moore, Petty and Palich (2006) argue that corporate responsibility is a price that company has to pay to operate in the market. It was further supported by Chang (2010) that the trade-off for the company in corporate profitability and corporate responsibility is due to increase of costs from being socially responsible which position them at financial disadvantage as compared to company with less CSR. Some studies suggest that cost of CSR are minimal

and company may benefit from being socially responsible in terms of productivity and employee morale and the incurred costs can be balance up by reducing in other costs.

## **Summary**

As such it is a challenge for MNE that in order to sustain in a competitive economic market and achieve profitability for shareholder investment, CSR is necessary. Being able to balance between corporate profitability and corporate responsibility is indeed the best result to both shareholder and stakeholder.

### **4. 1 Importance of corporate profitability and corporate social responsibility (CSR)**

In today's organizations many have place the importance of CSR as an added advantage over their competitors and the same time generating more profits for the organization. It is every shareholders expectation to receive high return from the investment hence to avoid conflict of interest in implementing CSR, it is important that CSR goals are aligned with company objective with the expectation of shareholders. CSR when it is properly analyzed using the same structures as the core business, can be a source of opportunity to enter new market and bring competitive advantage instead of being perceived as a cost and constraint to the company (McElhaney, 2008). Company that pursues after profit and without the concern for stakeholder will in the long run results in lack of sustainability hence it is important to connect and understand the various stakeholders and to satisfy their needs (Waldman, Kenett & Zilberg, n. d). Survey was conducted on international

business leaders and they believed that CSR activities have given them the benefit over top competitors.

#### **4. 1. 1 Profitability and CSR in Global Food Retailers**

The idea of CSR is seen as creating a shared value for the shareholders and also to the society. This can be seen in Wal-Mart for being the largest cash contributor for victims of 2005 Hurricane Katrina. In addition Wal-Mart had sent 1, 900 of emergency supplies to the affected places (Neff, 2005). This effort has greatly contributed to the company reputation thus reflected the core competencies and priorities the company placed. As such it enhances Wal-Mart corporate image in customer's mind and help in future profit growth through retailing as well as increase in stock price.

Another example can be seen in Tesco where making education as one of the corporate responsibility which allow a two-way transparency. For products that were purchased, customers can recycle by removing any unwanted product packaging and drop at the supermarket for recycling purpose. Creating such awareness among the customers not only is convenient to both customer and Tesco, it also help to give information on which packaging that is useful and which is unwanted. Research shows in organization that have transparency is more likely to gain greater confidence in value of sharing information within the organization and stakeholders (Riddleberger & Hittner, 2009). Adopting recycling activities enable cost reduction and generate revenue through developing a new product packaging from the recycle paper.

#### **4. 1. 2 Profitability and CSR in Air France-KLM**

Air France-KLM is the merger of two airlines with its own brand and identities. Implementing CSR as sustainable strategies is able to help the airline to remain competitive and improve the image of the airline. This can be seen in Air France-KLM where they placed the importance of stakeholders by ensuring no discrimination and equal opportunity in employee promotion (Som, 2009). In a service industry where mostly are customer service job, it is vital to maintain experienced and qualified employees instead of recruiting and nurturing new employees which will increase the company expenses. As such this help to keep costs down and in the long run profits can be achieved.

Besides showing corporate responsibility socially, the airline has place the importance towards environment by integrating with other organization to reduce CO<sup>2</sup> emission. In a highly volatile fuel price where fuel has been the main expenses for airlines, a fuel action plan was implemented which aimed to increase fuel efficiency on all flights and reduce CO<sup>2</sup> emission (Anttila & Kretzschmar, 2010). The plan stresses on fleet modernization as young fleet is able to save on fuel and the same time provides quality and comfortable aircraft to customer as a way to increase customer satisfaction and gain revenue and the same time reduce costs through savings in fuel. However to invest in fleet modernization a huge investment is needed therefore a good strategy is important to balance up both cost and revenue to avoid facing losses which may lead to failure.



### **4. 1. 3 Summary**

The examples of CSR activities performed by both the retail and airline industry shows the importance of incorporating these activities as part of the company objectives. Besides being able to build corporate brand and image it will attract customers into purchasing the product and service. However a proper and careful planning is required to avoid over investment which will cause losses to the company.

### **5. 0 Conclusion and recommendation**

In the globalization of airline industry strategic alliance is seen as the source of competitive advantage that gives the opportunity of growth, efficiency and profitability. Airline can no longer be able to operate alone and sustain in this highly competitive industry due to insufficient resources and capabilities. As such alliance with stakeholders, customers and competitors brings sustainability and enables required transparency. It is recommended that in order to sustain airline growth and profitability, CSR is an important strategy to be implemented and it has to be aligned with organization objectives with stakeholders. Therefore organizations will reap benefits of having efficient operations and balance up with different social and environmental network.

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