Alitalia airlines: financial crisis management

Environment, Air

Crisis survival for Alitalia: Strategy re-evaluation for its continuous viability in the medium and long term.

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Introduction

Based out of Rome, Alitalia is the national airline of Italy which was founded on 16 September 1946 under the name ‘ Aerolinee Italiane Internazionali’ and is known as ‘ Linee Aeree Italiane S. p. A. (Alitalia, 2006). Alitalia is 49% owned the Italian Ministry of the Treasury, other shareholders, which includes its employees at 49% as well as Air France – KLM which holds a 2% stake (Alitalia, 2006). As the leading airline in the country, Alitalia flies to more than 100 locales from its hubs in Milan and Rome, utilizing a fleet of 175 aircraft (Hoover’s, 2006). A major factor t be remembered and considered throughout this analysis and examination that Alitalia is a state owned airline and history has shown that the large staffs, inefficiencies, lower productivity and higher operational costs associated with such institutions makes them uncompetitive when matched against private industry. That legacy befell the fates of Sabena, Swissair and saw KLM Royal

Dutch Airlines become an acquisition by Air France in May of 2004 (BusinessWeek online, 2004). The liberalisation of the European airline industry was the beginning of the downward spiral for the indicated airlines as the process, as deregulation entails the removal of government restrictions which opened the domestic markets of all European Union countries to any company in Europe (Badi et al, 1995, pp. 245-59). The process of deregulation increased competitive levels in the industry thereby promoting heightened productivity, increased efficiency and lowered prices as markets were pen to the laws of supply and demand.

Under the deregulation process implemented by the European Union, legal monopolies as well as government aid for carriers disappeared, and aid reduction was supplanted by public funds, with most airlines finally becoming privatized (Ng and Seabright, 2001, pp. 591-619). Thus, the open sky policy, as it is termed, caused European airlines to restructure the manner in which they conducted business internally, through improving efficiencies as a result of direct competition. The main strategy that has arisen from the preceding has been the increasing of productivity. The emergence of the low cost carriers as a force in the industry has created additional pressures for the traditional full service airlines. The low cost carrier model of no frills, utilization of secondary airports and concentration on lower ticket prices has shaken the underpinnings of the traditional full service carriers which took off in Europe after the events of September 11th which generated a global melt down throughout the industry.

Prior to deregulation, the national flag carriers, such as Alitalia, were supported by monopolies, legal, and were dominant throughout the European community (White, 1979, pp. 545-73). Airlines during that era shared intra European routes as a result f bilateral agreements and the airlines companies were primarily owned by governments with their losses underwritten by public funds (White, 1979, pp. 545-73). This structure left little incentive for bottom line accountability, productivity or innovation, a situation which aptly describes Alitalia, and this atmosphere served to shape the company’s operational and management culture as a job with Alitalia was decidedly plush and devoid of the usual performance standards. Today’s market has seen a shift to where almost all of these carriers have been privatized, with the disappearance of the corresponding government aid, and the legal monopolies have disappeared.

Alitalia has always been a plodding governmental type airline operation, burdened with over staffing and low productivity. Examples of the foregoing can be found in the fact that Alitalia pilots average less than 500 flying hours per year versus the industry average f 600 to 700 for most carriers in Europe (BusinessWeek online, 2004). Half of the company’s fleet consists of high maintenance McDonnell-Douglas airframes that cost twice as much to operate than the newer more efficient airframes resulting in what analysts estimate as operational costs that are between 30% to 40% above the industry norm of other European Flag airlines (BusinessWeek online, 2004).

The historical summary of the airline climate in Europe prior to deregulation, and the nuances of the monopolistic environment surrounding the flag carriers is an important background variable in understanding the manner in which Alitalia evolved, and the underpinnings of its organizational and cultural structures. Indicative of the waste which is prevalent in the company, as indicated by the examples of pilot flight hours and the age as well as composition of its fleet, is that the crews for the Milan hub live in Rome and commute via the airlines flight to work, occupying on average 60 percent of the seats on the morning flight (Business Report & Independent Online, 2006). The preceding example along with the other samples of waste serves to illustrate the spending and lack of fiscal accountability at the carrier. Also at fault, as a main contributor to the operational waste the airline generates, is the political climate of the country and how it impacts on the carrier. As a government controlled entity “ Alitalia has always been a place where politicians could get their people hired …” stated Allessandro Frigerio, fund manager for Pigoli Consulenza (Business Report & Independent Online, 2006). This type of mentality says more about the climate the company operates in than any other, thus over staffing is a natural outgrowth.

The preceding represents the historical corporate culture setting which prevailed during the industry shaking events of September 11th. As a result of the foregoing that date is utilized as a starting point for the discussion of the company’s financial situation. In revisiting this date, it must be remembered that the global economy was in the throws of a recession. The United States economic slowdown was pegged in March of 2001, and Japan along with Germany exhibited nearly zero growth (Drakos, 2002). The foregoing was the economic stage upon which the events of 9/11 transpired setting off shock waves in the global economy, inhibiting both leisure as well as corporate travel as a result of fear and the recession. The last year Alitalia recorded a profit from operations was in 2000, and the company has been unprofitable for 11 of the past 16 years (Business Report & Independent Online, 2006). In 1999, Alitalia registered a net income of €380 for each of the company's 20, 770 employees as compared to losses of €23, 400 for each employee in 2003 (Business Report & Independent Online, 2006).

The aviation industry lost an estimated $25 billion since the eventful date of 9/11 through 2003 and airlines have reacted to the economic realities by laying off in excess of 100, 000 employees as well as remove an estimated 700 airframes from service to cut costs (Amos et al, 2004). The culture of Italy is adverse to shedding employees as a cost cutting measure, as evidenced by a 1970 statute that requires any business with more than 15 employees to appear in court to justify any layoffs or firings, failing that, company's would have to rehire said workers and compensate them up to three months in lost wages (Bloomberg. com, 2004). In response to the economic crisis prompted by the global recession and the events of 9/11, the then Chief Executive Officer of Alitalia, Francesco Mengozzi announced a plan whereby 1, 200 jobs would be outsourced to effect economies in operations, and an additional 1, 500 jobs would be cut, with wage scales frozen. The preceding action resulted in the company's unions initiating three strikes, one of which resulted in the cancellation of half of the airline's flights, upsetting the plans of more than 18, 000 customers (BBC News, 2004). The layoff plan was an attempt by management to cut costs in an effort to head the company back towards profitability and possible privatization, as well as a potential alliance with Air France and KLM Royal Dutch Airlines (BBC News, 2004).

The Italian government led by Prime Minister Silvio Berlusconi fired Mengozzi and replaced him with Marco Zanichelli who subsequently put forth a plan to either fire or contract out a total of 3, 300 jobs. That recommendation also got Zanichelli fired, paving the way for the installation of Giancarlo Cimoli as Chairman and Managing Director. The problems created as a result of the global economic slowdown and the events of 9/11 were further exacerbated in Europe by the introduction of the low cost carrier business model, which was based upon the successful concept utilized by Southwest Airlines in the United States (Southwest Airline, 2006). Companies such as Ryanair have successfully entered the Italian market and accounted for 45% of the flights originating in Italy in 2002, which increased to 51% in 2003 and rose to 66% in 2004 (Business Report & Independent Online, 2006). The low cost model has proven to be a successful concept in that southwest Airline in the United States has remained profitable throughout the recession and events of the recession of 2001 as well as 9/11 and subsequent events, while in Europe easyJet, Ryanair and other low cost carriers have been expanding at the expense of flag carriers such as Alitalia (Drakos, 2002).

The European airline market differs from the American airline industry fundamentally in the areas of their respective regulatory histories as well as the smaller size of their carriers (Ng and Seabright, 2001, pp. 591-619). Baumol et al (1981, pp. 231-56) advise that corporate theory to address the effects of reduced earnings owing to adverse economic and or competitive conditions is to utilize the conditioned demand function with defines the operation of cost functions. This states that the reduction of costs and implementation of diversification and innovation are solutions to be addressed in such circumstances. The failures of Alitalia in effectively implementing such measures over the past 16 years, along with the company's corporate culture, unions and the political climate of the country have hampered all efforts to return the company to profitability and compete with rivals. Prime Minister Silvio Berlusconi has stated that the airline "… has twice as many workers as necessary and this has been something that has been inherited from the past …" (Bloomberg, 2004). Berlusconi when on to add that it is difficult to cut costs at the carrier "… because any cuts provoke the kind of reaction from unions and workers …" (Bloomberg, 2004) that result in strike and work stoppages.

The preceding effectively indicates the reasons behind the financial crisis facing Alitalia presently:

- an oversized and unproductive work force that resists management actions to implement measures to cut costs,
- a company as well as political culture that is still rooted in policies of the pre deregulation era,
- a lack of response to the inroads of changes in the airline industry as marked by Emirates and Singapore airlines that emphasis customer satisfaction and service,
- as well as a failure to respond to the inroads and profit generating models as shown by the low cost carriers

Customer opinions regarding the company are reflected in the Skytrax survey of 2005, which reveals the following on varied areas:

Table 1– Alitalia Customer Survey Comparison

(Skytrax, 2006)

Category	Alitalia Number of Stars	Emirates	Ryanair
Quality of product /Staff service in Airport and onboard environments			
Business Class	4	4	
Economy Class	3	4	2
Airport			

Services			
Check in service – Business Class	4	4	
Check in service – Economy Class	3	3	2
Transfer services – Business Class	3	3	
Transfer Services – Economy Class	2	2	
Arrival Services	2	3	1
Business Class Lounge –	3	4	

product facilities			
Business Class Lounge – staff service	3	3	
Onboard Features – including in flight Entertainment			
Cabin Safety Procedures	3	4	3
In-flight Entertainment	3	5	
Amenities, Blankets, Pillows,	3	4	1

etc.			
Airline Magazine, Newspapers, etc.	4	4	1
Cabin seat Comfort			
Business Class – long haul	4	5	
Business Class – short haul	4	3	
Economy Class – long haul	4	4	
Economy Class – short haul	3	3	3

Cabin Staff Service			
Business Class – service efficiency	3	4	
Business Class- staff attitude and friendliness	3	3	
Economy Class – Service efficiency	3	3	2
Economy Class – staff attitude and friendlines	3	3	2

s			
Responding to passenger requests	3	3	2
Cabin presence through flights	2	3	2
Assisting Parents with children	4	4	1
Staff Language Skills	2	4	1

Legend – 5 stars = Excellent

4 stars = Good

3 stars = Fair

2 stars = Poor

1 star = Very Poor

The preceding indicates that while unprofitable, the staff at Alitalia is performing at levels that are comparable to one of the world's acknowledged best airlines, Emirates, and at a level that exceeds Ryanair, the market leader in passenger flights in Italy. Dealing with the aftermath of the economic events of 9/11 and the new competitive market will require the company to make changes in the manner in which it does business internally to enable it to cut costs and offer product route that are profitable.

Alitalia Management

The effects of deregulation and the introduction of the low cost carrier model in the airline industry has changed the context of management within the industry in Europe. The state supported monopolies and subsidies as well as the protectionist climate has given way to a true business model whereby the cost of the product to reach destinations represents one of the most important considerations. As shown via Table 1 – Alitalia Customer Survey Comparison, the company compares favorably with Emirates Airline on service and score well ahead of Ryanair in all facets, yet Emirates is regarded as one of the best carriers in the world, and Ryanair has accomplished the feat of securing 66% of all passenger departures in Italy. These facets point to operational modes regarding overhead as the key reasons for the company's dismal earnings and profit performances. Delfmann et al (2005, p. 20) advise that the "… the most spectacular growth over the last 20 years among all transport sectors has occurred in aviation …". This contrasts to the 11 years of unprofitable operations shown by

Alitalia over the last 16 years. Delfmann et al (2005, p. 20) add that "… increasing competition between network carriers has been given added impetus by the emergence of new, low cost carriers". This climate has provided passengers with a wider array of destination choices, timetables and prices from which to select.

As a fiercely competitive business, to prosper and survive in the airline industry, carriers must address the factors which prompt passengers to fly as well as streamline internal operations to reduce costs so that they can trim ticket prices. This model has proven successful in the low cost segment, and also has served the full service carriers in working their way back to profitable operations. Ryanair has captured a huge segment of the departures from Italy by adherence to these principles, which Krzos et al (2003) refer to as the application of knowledge management skills to define the key aspect of operations and thus focus on getting said areas up to and exceeding industry standards. Knowing what the problems are is the first step to devising solutions, and the application of knowledge management skills such as (Krzos et al, 2003):

- Flight Scheduling
- Pricing
- Support Services
- Crew and Staff Scheduling

Represent internal key to aid in competitiveness. Flight scheduling represents charting and understanding the departure, arrival and destination preferences the market has and is showing and responding to these patterns through the arrangement of flights to met this demand (Krzos et al, 2003). Pricing represent a function of internal operations and efficiencies whereby waste, over staffing, and productivity impact on operating expenditures and the reduction of these costs permits reduced ticket pricing. The preceding brings up the issue of support services and crew / Staff scheduling which are personnel, policy and corporate culture problems at Alitalia.

McAfee and te Velde (2004) indicate that the utilization of yield management is an important set of strategies that increase profits through the understanding of metrics in industries such as airlines. Yield Management is helpful when a product has two important characteristics (McAfee and te Velde, 2004):

1. The product has a pre-set expiration at a definitive point in time, as evidenced by hotel rooms, airline tickets, and or time-dated products, and
2. the capacity for same is known and fixed in advance and can only be changed at a high cost

McAfee and te Velde (2004) state that forecasting the preceding utilizing present sales, competitive data, overall demand and forecasting provides companies with the ability to vary elements of their fixed cost, such as staffing, equipment, and facilities to put these resources to work at where they will meet the supply demands and reduce waste. The application of yield management has shown results for American Airlines which generated an additional $500 million through the application of this technique. Bieger and Agosti (2005, pp. 41-64) advise that management needs to be cognizant of and focus on:

- asset utilization, such as facilities, fleet costs, landing charges, handling charges and pro-rating of tickets,
- increased utilization of low cost subsidiaries to take over operations where the market model indicates a better fit with a division within the company,
- understanding the operational cost of fleet dynamics, fuel and operational costs of equipment
- alliance strategies for key business areas,
- staffing,
- airports

These core business areas, with respect to the airline industry represent the means via which to focus operations on profitable business generation and reduced internal costs to maximum returns.

Alitalia's management practices have exhibited operational aspects that have run counter to the preceding management theory applications. The most obvious hamstring on management operations is a result of the government appointment of top management staff. Such an example is provided by the appointment of Giuseppe Bonomi, who served as Chairman for one year, and was an ally of Prime Minister Silvio Berlusconi, and a member of his Northern League separatist party (Business Report & Independent Online, 2006). The problem of political influence has helped to create the company's choice of a poorly performing fleet which consists of U. S. made MD80 and Boeing airframes that were purchased "… to please the

Americans ...” as stated by Oliviero Baccelli, a professor who teaches at Bocconi University in Milan (Business Report & Independent Online, 2006). The preceding fleet choices are coupled with Airbus airframes and ATR planes thus creating a highly diversified fleet which increases ground maintenance, crew training, staff familiarities and inventory problems, having a tremendous upward effect on costs. Baccelli summarizes the preceding mix and match of differing airframes by stating that “ Alitalia has always been managed with diplomatic goals in mind”, a view that is also shared by Marco Ponti, who serves as a professor at Politecnico University, who stated “ Political interference has led to choices to please special interests and not the bottom line” (Business Report & Independent Online, 2006).

This type of climate has hampered effective operations and efforts on the part of management. Further examples of the preceding as shown as follows (Bloomberg, 2004), (BusinessWeek online, 2004).:

- The company’s unions have indicated that areas such as contracts for purchasing, as well as commercial costs have been excessive over the past ten years. Through renegotiating contracts the company would stand to gain an estimated €200 million yearly which represents approximately ten percent of costs as represented by areas such a food, fuel and the costs of maintenance.
- The company either needs to add routes to fully engage its over staffed operations or trim its workforce to match the level of flights.

- The multi airframe problem is illustrated by a cancelled flight from Malpense to Palermo in June of 2004 as a result of the fact that a replacement tyre could not be found.
- The politically charged investment in the airport at Malpensa which does not have any highway or fast train links to Milan. Despite this fact, Alitalia increased the size of its workforce at the airport by seven percent in 2001 for additional ground staff which were mostly idle due to reduced flights.

The preceding illustrate the inefficient operations as well as limitations and political influence that have helped to hamper management's efforts in the face of applicable management theory and operations germane to the industry.

Re-focusing Alitalia

The preceding events and long history of inefficient operations resulted in the appointment of Giancarlo Cimoli as Chairman and Managing Director of Alitalia. The situation had become so dire for the company that Cimoli stated that he had plans calling for splitting the company into two parts and to cut 5, 000 jobs as a tactic which got the attention of unions who had effectively blocked all job cutting efforts in the past " (Business Report & Independent Online, 2006). The tactic has apparently worked as the company and the unions, along with the government have agreed to a series of agreements that were signed in May of 2004 that paved the way for guidelines for the company's restructuring plan (Alitalia, 2004). The " Director's report on the activities of the Alitalia Group and Alitalia Linee Aeree Italiance S. p. A. in the first six months of 2004" stated "… it has been clear for some time that the grave financial and profitability crisis the Company finds itself in requires a prompt change of approach”. This sobering thought is seemingly back up by sweeping changes as contained in this plan, which are as follows (Alitalia, 2004):

1. A ‘ Bridge Loan’ amounting to €400 million the company as guaranteed by the Italian Government under EU regulations to enable the company to meet its fiscal obligations through March of 2005.
2. The business plan for the period 2005 through 2008 devotes itself to the creation of conditions that will result in a rapid and sustained return to profitability, utilizing restructuring as a means to increase efficiency and set the stage for what the company terms as a re-launch in 2007 as represented by more favorable economic, market and business conditions. Said plan calls for:

- the moderisation of the company through the restructuring of procurement contracts for fuel, food, maintenance, general purchases and all commercial activities.
- A major re-launch and restructuring of the following:

1. Restructuring of the two hubs in Rome and Milan to provide increased company exposure and the lack of adequate use of assets. This area is meant to respond to the inroads of Ryanair that holds 66% of departures from the country.
2. Increase of flights and attractive routes to stave off competitive inroads

3. Improvement of the company's airframe fleet to remove aging aircraft and provide a smoother mixture of maintenance and parts inventory via a reduction of model types.
4. Reposition and improve the brand name to exploit its ? Italian Style' by focusing on customer satisfaction and improving services to improve public image.
5. Restructure the pricing of products, yield management techniques, through an overhaul of the fare structure and change in pricing procedures to meet competitive innovations.
6. Upgrade the use of technological innovations such as the Internet to sell tickets and provide customer information in keeping with the Internet oriented practices of the low cost model with has proven to be user friendly and used by customers in securing tickets.

- Redesign of the support and operational activities in flight as well as procurement and operations.
- Enhance the airline's positioning in the European as well as Italian market to defend the company against inroads from rival carriers and then to aggressively pursue the acquisition of increased market share through winning back demand and use by Italian passengers as well as Europeans.

Cimoli implemented the creation of AZ Fly, which handles the core business activities of the company as represented by (Alitalia, 2004):

- Marketing and Network,
- Flight Operations
- Sales and Distribution,

- Product Integration and Delivery,
- Cargo,
- Specified Corporate activities, and the
- Governance of activities constituting this new subsidiary

In addition, Cimoli created AZ Servizi which will handle (Alitalia, 2004):

- Engineering and Maintenance, representing engines, allied components and engineering services,
- As well as ground handling,
- ICT,
- Sale of services as well as products to third parties,
- Shared services such as Administration, Planning and Control, Human resources, Centralized Business Services, and Call centers

Cimoli’s plan divides the airline’s operations into external (customer, flight and related public activities), and internal operations to split the union’s influence and thus make each service or operational center accountable for achieving operational goals. This technique is described by Delfmann et al (2005, pp. 65-96) as consolidating the business model and shifting the orientation of the business to customer centric operation (Delfmann et al, 2005, pp. 97-117).

Recovery

The global economic recovery has aided in Alitalia achieved measures of success n its restructuring plan. The following list the areas that the company has achieved since Cimoli’s plan was implemented:

- The company trimmed its losses in 2005 to €167. 5 million from the €858 million it lost in 2004 by the spin off of divisions indicated in the Director's report on the activities of the Alitalia Group and Alitalia Linee Aeree Italiance S. p. A. in the first six months of 2004, which contained Cimoli's restructuring plan. The preceding has not been accomplished without clashes with the company's unions over job cuts that have reduced labor costs by close to one third. In addition the company's revenues increased by twelve percent to €4. 797 billion, and increased passenger traffic by eight percent over 2004 levels (BBC News, 2006).
- Implemented the cut of 3, 700 jobs, representing an estimated one sixth of the workforce thus amounting to €280 million in savings (USA Today, 2004).
- The acquisition of Gandalf Airlines, a regional carrier that is based out of Orio al Serio Airport in Milan that flies jet as well as turboprop planes to such destinations as Barcelona, Bari, Madrid, Paris, Milan, Catania, Brescia, Pisa, Stuttgart and Verona. This move enabled Alitalia to gain access to additional slot facilities at a number of European airports and helped to increase passenger traffic (Alitalia, 2005).
- Reduced fuel costs in 2005 by 10% (Alitalia, 2005).
- Reduced sales cost to 13. 5% in 2005 from 17% in 2003 (Alitalia, 2005).
- Increased Internet ticketing to 49% in 2005 from 11% in 2003 (Alitalia, 2005).
- Increased personnel productivity by 43. 4% (Alitalia, 2005).
- Increased passenger traffic by 7. 8% over 2004 (Alitalia, 2005).

- Increased passenger traffic revenues by 11. 3% over 2004 (Alitalia, 2005).
- Increased pilot productivity by 12% over 2004 raising pilot flight hours to 563 from 504 (Alitalia, 2005).
- Increased the medium and short haul fleet utilization turnover by 15 minutes in 2005 over 2004 (Alitalia, 2005).
- Increased revenues by 11. 6% to 4. 797m euros from 4. 299m in 2004 (Alitalia, 2005).
- Decreased operating costs by 2. 9% to 4. 537m from 4. 674m in 2004 (Alitalia, 2005).
- Reduced the losses to 168m euros in 20