Advantages of airline mergers

Business, Industries

Airline Mergers like mergers and acquisitions in other businesses brings advantages and opportunities applicable to M&A. As in other businesses, some airlines have to merge for pure survival and to avoid bankruptcy. Others could do so for expansion, improved profitability and improved services. Horizontal Merger of Airlines: Horizontal merger allows two or more airlines to merge to form a new airline or operate under the name of one of the merging companies. The bankruptcies, mergers and liquidation of late 1980s were a result of financial problems due to strict competition and high operating costs.

The mergers and acquisition of the period allowed the airlines to consolidate their business instead of outright closure. The customers benefited from these mergers in the shape of continuity of the services albeit at a reduced scale. In absence of the mergers the services being offered by the airlines in difficulty might have closed. Economies of Scope Merged airline benefit from the economies of scope, this economy comes from the benefits of the size of the airlines flight network [Jerram et al, 1997], the advertising, for example covers the entire network and not just a single route.

Benefits of economy of scope also apply to the computer registration system, customerloyaltyrewards such as frequent flyer miles etc. Synergies Synergies are better use of complementary services. The merged airline can have the advantage of increasing revenue through cost savings. Purely from an airline perspective, the new company can relieve the surplus workers involved in similar jobs in separate companies. Staff in several departments such as accounting, marketing, customer services, marketing and other departments become surplus and can relieved with a compensation package to reduce future costs.

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Economies of scale also fall under synergies, in a larger company, the bargaining power of supplier is reduced and all types of supplies can be negotiated at a more competitive price. A larger airline is in a better position to raise capital for the company. The larger airline also has the advantage of higher visibility. US airways in its bid to takeover Delta Air Lines claimed that joining the two airlines will produce synergies leading to cost savings [Karp, 2007].

Diversification: Airline mergers can provide the opportunities for diversification to the merged company.

The new company can get access to hubs of the other company and access to its attractive routes. The passenger of the two airlines on common routes will only use the new merged airline, improving utilization of available capacity to improve profitability. Vertical Integration Another possible advantage of merger can be vertical integration of the two companies. An airline operating on domestic routes only can acquire a company with international operations to enter the international market.

The acquired or merged company may also bring other assets such as hotels or overhaul workshops or other parts of supply chain allowing the new company to expand vertically. Taxes: Many profit making companies can acquire other loss making companies facing liquidation or bankruptcy at a throw away price. US air was offered only $8 billion initially for Delta Airlines and later raised it $10. 2 billion. A profit making company acquiring loss making airline can claim tax write-offs but these write offs have to be justified to regulatory bodies to prevent misuse of this facility.

An airline facing closure and job losses can often have a sympathetic consideration from the tax authorities for tax concessions. Purchase mergers involve purchasing an airline in cash or as a debt instrument. This type of purchase allows the acquired assets to be written-up to the actual purchase price. The difference between the book value and the purchased price can be allowed to depreciate annually to reduce the tax payable by the new or acquiring company [M&A, 2007]. Arguments for Further Consolidation

United States airline industry has already reduced to six major airlines; American, Continental, Delta, Northwest, UAL Corp., and US Airways. The talk of further consolidation as discussed recently in US Airways and Delta Airlines merger proposal and Continental and Northwest joining hands too sent shivers down the spine of air traveler due to potential disadvantages of mergers resulting in oligopolistic conditions. The advocates of further consolidation however see advantages in further consolidation too [Szamosszegi, 2000].

They argue that further consolidation should be seen as a continuation of deregulation process. Szamosszegi cites a study by the Economic Strategy Institute (ESI) and GKMG Consulting services . The study analyzed various individual markets served by the big 6 and assumed that the big six merge into three consolidated groups. The ESI-GKMG study showed that under such a scenario, the passenger will be able to reach more destinations without switching airlines, get more free-flier miles.

The study claimed that it would create more competition in 74% of the destinations, decrease competition in 13% of the destinations and remain unchanged in the remaining 13% [Szamosszegi, 2000]. The report also claimed that consolidation's benefits will extend to international travel too as smaller destinations will also be able to benefit from international market access. The authors however, do not say why the airlines will continue with the present combined network and not redesign the network without fear of competition.