When the Network Strategy Is Not Enough
-The case of European Full-Service Airlines

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The 1990s were one of the most profitable periods for European airline companies, mainly because of development of world economy and increasing globalisation trends. However, towards the end of the decade, a global economic downturn, high oil prices and new forms of competition turned the industry towards troubled times. The European air-travel industry had to face and accept the new airline business concept, called low-cost or no-frill airlines. In these conditions, traditional airlines had to rethink their strategies and question the old business model. As a response to the competition, European traditional full-service airlines formed alliances or networks to expand the route network and to increase efficiency. Although joint actions of airlines within alliances started to grow, full-service airlines continued to report losses in the weak business environment, in which the low-cost airlines were growing. This thesis aims at identifying the strategic decisions the European traditional airlines have made during the recent downturn in the industry and how the case companies perceive customer value in the alliance they are members of. In order to conduct this study, the authors have chosen two airline companies from two large European alliances. Interviews have been used as a main information source. Interviews were conducted with managers of companies, which at the same time were representatives of companies in the respective alliances. The secondary material such as previous interviews, annual reports of companies, recent studies in the field, were used as complementary data. Findings and analysis at the end are introduced in response to general market situation, and as a company - alliance information.
Forewords

The Authors of this Masters Thesis would like to use this opportunity to thank all the people who contributed to the research process. First of all we are very grateful to the airline representatives who offered us their time and shared valuable information that creates the basis for the findings and analysis. Thank you Mika Sucksdorff and Kim Möller. Without the Linköping University’s Jörgen Ljung’s guidance the thesis would most likely look very different, and without the opponent students the structure might still be unclear. We appreciate the help we have gotten from not only opponents and seminars but from all fellow students and friends.
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1. Background

1.1. Introduction

This Master’s thesis attempts to understand the strategic views of top management within the traditional service airlines operating in Europe. The focus is in the European market competition strategies, in the hard competitive environment against the low-cost operating airlines. No-frill Airlines, such as Ryanair, offer cheap ticket fares with no additional in-flight or on-ground services and they seem to be growing larger as well as multiplying in numbers. Many European traditional government-owned airlines are left with a struggle of cutting costs.

Air transportation services can be divided into two main business areas: airports that offer the on-ground operations for flights and the airline companies that offer the flight transportation between airport destinations. In these businesses quality is mainly focused on punctuality, reliability and service. Airline companies have a tendency of being homogenous in similar terms of sales, service and transportation quality in the air.\(^1\)

The topic of traditional airline strategies is interesting since many analysts have predicted that the number of airlines in European market must still decline, only few will survive. What is the managers’ view of the situation and the successful future strategies? Do the traditional airlines see threat in the future created by the growth of the low-cost airlines such as Ryanair and what is their strategic response to them? Alliances have been a growing strategic trend in the industry and are expected to be still strengthening in the future. Their role in the competition

\(^1\) Albers, Koch & Ruff 2004
is important. Many large companies have already laid-off a lot of their customer service personnel as well as outsourced many parts of the value chain. (Value Chain is tool for analysing companies’ strategically important activities to primary and support activities and was created by Michael Porter in 1985. Explained in detail in Theoretical Framework part of this thesis.) It is hard to compete with the low-cost airlines by only cutting the costs when the target customers still require service. The low-cost airlines have developed their value chains so effective in low-cost operation that they are hard to imitate by competitors, especially by traditional airlines. Differentiation as a competitive advantage requires creating higher customer value than the competitors. Usually in airline business this has meant more service and giving priority to business customers.

Through its history the commercial airline industry has been facing changes. Technology has had an important effect on the industry as well as governmental and international regulations. One of the biggest changes in the history that the companies in the industry face is the price competition that low-cost airlines entering the market create in both Europe and the US. Passengers have more choice and there are more and more airlines entering the market, which means that there simply is not room for everyone. Many airlines have reached the critical point when they need to re-think their corporate strategy. A common way for doing this, presented in most of the strategy literature, is finding answers to the questions “where do we want to go and how do we get there?”

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2 Economist 2004
3 Skat-Rordam 1999, p 12
1.2. Problem Discussion

In the field of strategic management there is a lot of published material available, many contradicting each other. Strategies are created in many levels from the networks to business units. This thesis concentrates on the business and network level of strategy without forgetting examples of company level strategies in different European airlines. As case companies, two member airlines of different alliances are studied: Finnair, a member of the oneworld alliance and Scandinavian Airlines, a member of the Star alliance. The name SAS Group will be used for Scandinavian Airlines in this thesis. Both their company and alliance strategies are analysed, combining the views of the European airline industry level.

There are many theories and studies previously written on the field of low-cost strategy versus differentiation. Michael Porter presented in the 1980’s a competitive advantage theory about company strategy being either cost leadership or differentiation. According to him the combination of two strategies is not possible. Porter’s theories offer tools to analyse the industry (five forces model), strategically important internal operations (value chain analysis) as well as competition and level of customer value.

When determining which business the company is in and who are the competitors, the first step for any company is to identify what customer needs they attempt to satisfy. An international airline company has a number of customer needs it satisfies and is working on different areas such as: Transportation (both passenger and air freight), communication, leisure, tourism services, information, logistics and sales. Also included in the complete service package are catering services, technology (mechanics, electronics, aircraft maintenance) ground services.
at airports (check-in, gate operations, luggage, ticket sales, information, claims etc.).

Many airline companies have outsourced several areas and concentrate on the ones that they consider as their core businesses. Which business areas an airline considers as its core business and chooses to emphasise, depend on the strategic choices made.

To analyse an industry, the term and limits of the industry in question must be determined. In this thesis work the airline industry is considered as a part of tourism and service sector, including all airlines operating passenger flights between European destinations. Transatlantic and other long haul flights as well as air freight are not of interest in this thesis. In this way the industry is determined by the service the companies offer and the market they serve.

Change in an industry can begin from effects outside, for example from technological development, economical, political or social pressures, but also companies inside the industry can create variety and change. In the airline industry the obvious outside effect in the past years has been the attack against the World Trade Centre two towers in September 2001. Even prior to this the European market was mature, many airlines were in financial trouble and customer needs were changing. Due to recession in many parts of Europe, the number of business passengers was in decline and no-frill airlines found their niche to start operating low-cost flights all over Europe. These companies (mainly Irish Ryanair followed by others) grew fast by tightly holding to the low-cost structure of the value chain.

By the change of millennium many traditional airlines found themselves in a difficult situation with a desperate need of new strategies.

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4 Shaw 1999, p 7-8
5 Skat-Rordam 1999, p 17
Some went bankrupt, many national airlines got heavy funding from the governments, and some answered the competition by creating their own subsidiaries offering flights with low fares and minimum level of service. Many traditional airlines relied on rapid and heavy cost cutting, laying off a large part of their personnel and re-engineering the organisations. Multi-lateral alliance strategy became increasingly important way of coping in the competition.

By analysing strategies of different European Airlines and multi-lateral alliances, this thesis aims to answer three main questions, which are presented in the form of research questions in the following paragraph.

*Research Questions:*

√ How do airlines create customer value?

√ What have the European traditional airlines done in order to increase productivity and efficiency?

√ Do alliance strategies offer competitive advantage for the traditional airlines in the future?

1.3. Purpose

The goal of this Masters thesis is to find out what strategic decisions the European traditional airlines have made during the recent downturn in the industry. The empirical and analytical parts present how the alliance member airlines perceive the competitive situation with low-cost airlines and the customer value in Europe, especially focusing on the
cases of the Scandinavian Airlines in Star alliance and Finnair in oneworld alliance.

1.4. Scope

The empirical study offers useful information for airline companies, benchmarking type of view into the present situation in the industry from the strategy point of view. Also any business student interested in the tourism and airline industry could benefit from reading this thesis about the strategic management of traditional airlines.

In the pressure of competition many airline companies that originally didn’t start with low-cost strategy, started a cost cutting program in attempt to survive. The cost leadership versus differentiation has lost its meaning in many industries. Until recent years the airline industry has clearly seen these two different strategies but today more complex choices have replaced the two generic strategies.

Cutting costs and re-engineering organisation results in most cases only short term increase in profitability. The cash saved needs to be used for new innovations and development otherwise the company could end up with less revenue. Strategic thinking should guide companies’ long-term principles in creating profits and finding opportunities in the market. Creative pricing, promotion actions and segmenting target markets take more time but often offer better long term results for a company than only cutting costs.6

Alliances can create better bargaining power towards suppliers and offer customers more value in creating a worldwide contact network. There are three alliances in the European Market at present, Star alliance, oneworld alliance and SkyTeam alliance.

6 Skat-Rordam 1999, p 13
1.5. Disposition

The background part of this thesis will give introduction to the topic and present the research question, also limiting the area of study according to the type of companies analysed as well as the market area considered. The aim is to give the reader an understanding of the research problem, approach as well as to define the air-travel industry. Methodology part presents the research design used in this thesis work and the principles of qualitative management research guiding the empirical study.

The theoretical part consists of definition of business strategy, creating competitive advantage, Value chain as a strategic tool, Porter’s generic strategies (cost leadership, differentiation and focus strategy), network strategy, customer value and a look at industry analysis. This chapter starts with the general presentation of how business strategies are created and how to gain advantage over competitors. Porter’s cost leadership and differentiation strategies can be identified in the airline industry. Network strategies are reality to all companies today and one type of network is a strategic alliance between several partners.

The Empirical part begins with combining data from various secondary sources in order to present the 2004 situation in the European air-travel industry from the strategy point of view. The alliance strategies are given an important role since they represent strategic decisions that traditional airlines have made and goals they attempt to achieve. The primary data gathered in personal interviews finds out how the traditional airlines (especially Finnair and Scandinavian Airlines) perceive successful strategies in the industry and the situation in the European market. Some companies will move closer to the low-cost strategies with less service personnel while some low-cost airlines are forced to increase their costs when expanding the business. The companies need to be aware of their
competitors’ actions at all times, monitoring closely the changes in the market. Alliances offer one way of doing this. In addition to personal interviews with the alliance member representatives, information from annual reports and CEO interviews available in company www sites or other publications are presented in the empirical part.

In the analysis part of the thesis the findings of personal interviews in the empirical study are compared to secondary data for analysis of European full-service airlines’ strategies. For most current information secondary data from media and Internet sources is evaluated. Using the models presented in theoretical part, different analysis of the industry, European market, network relationships and strategic decisions that the companies have made are analysed. The aim of analysis is to find out how airlines perceive customer value and how alliances can help airlines in competition as well as traditional airlines cost cutting strategies. The analysis is built around the two case companies but also to create a larger picture of the industry situation at the end.

Background, theoretical framework, empirical study and analysis are all formulated in the same way. The chapters begin with general presentations and definitions, narrowing the scope into the relevant theories and findings that this thesis wishes to concentrate on. The empirical and analysis part also turn the perspective on the industry level again, generalising the topic from the case companies to the whole European industry towards the end of the chapter.

Finally, in the end of the report are conclusions. In this part, a short summary of analysis and whole thesis will be introduced and answers to research questions highlighted.
2. Methodology

For convenience of readers, this chapter begins with a general discussion about the scientific research, different aspects of business research and different research methods. The aim of this chapter is to provide understanding for the research process, research approach and methods used throughout the thesis.

2.1. Scientific Research

It is obvious that scientific research has its origins in pragmatic problems of real life. Interest in basic research comes only after acquiring some field knowledge. Scientific research can be defined as a “systematic, controlled, empirical and critical investigation of phenomena guided by theory and hypotheses about the presumed relations among such phenomena.”

(Source: Bryman 2001, page 22)

Different ways of conducting a scientific research depend on the purpose and results found. They can be classified as exploratory, descriptive, explanatory and predictive.

Exploratory – This type of study is needed when the area studied is new or unclear. By using a case study, document analysis, observations or in-depth interviews can exploratory researches formulate more precise questions or testable hypotheses. Descriptive – such studies try to find answers to the questions who, what, when, where. The researcher attempts to define a subject or describe it in detail, usually by creating a profile of a

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7 Bryman 2001, p 22
8 Cooper & Schindler 1998
group of problems, people or events. This type of research is popular in business research, for defining an event. The study however cannot answer to questions why the event occurred and why did the variables interact in a certain way.\textsuperscript{10} \textbf{Explanatory} - in this kind of study theory is created to answer why and how questions. Explanatory study attempts to explain the reasons for a phenomenon and go beyond the definitions created by descriptive research.\textsuperscript{11} \textbf{Predictive} – If a plausible explanation can be found for an event after it has occurred, it is desirable to predict when and in what situations it will occur again. In business studies predictive research can be found when evaluating specific actions and forecasting future values.\textsuperscript{12}

This thesis study is mostly formed as a descriptive research, describing the strategic situation in companies and market area chosen. The thesis creates an overall picture of the European air-travel market, then analysing current strategies of traditional airline companies. The study has explanatory characteristics, attempting to find patterns and reasons for strategic decisions. With the limitations of findings, some predictions for the future and strategic suggestions to companies can be given, in order to overcome the currently existing challenges and to create competitiveness in the future.

Any good research must meet a certain criteria of systematic planning, process and analysis. The purpose of a research must be clearly designed, limitations and scope presented and research design well planned. The design and process of the research depends on the type of study, the methods chosen for data collection, analysis techniques and availability of data. High ethics is to be kept in mind through the research process and when presenting the findings, to keep the study un-biased.

\textsuperscript{9} Cooper & Schindler 1998, p 134-135
\textsuperscript{10} Ibid, p 11
\textsuperscript{11} Ibid, p 11-12
\textsuperscript{12} Ibid, p 12
Findings must be clearly presented and logically organised in order for analysis to match the findings.  

### 2.2. Research Type

In scientific research, it is very important to determine which research type is going to be used. There are two main research methods: Quantitative and Qualitative. The easiest way to make distinction between these methods is to point out that while quantitative research deals with numbers, qualitative research deals with words. This explanation would be too simple for clear understanding, and in order to present the methods used in this thesis, the both research methods are given a short description.

Broadly speaking, quantitative methodology can be described as entailing the collection of numerical data and exhibiting a view of the relationship between theory and research. Also quantitative method is seen as deductive, a predilection for a natural science approach, with objectivist conception of social reality because of hard data. Main methods used in quantitative research are surveys, self-completion questionnaires, structured interviews and structured observations. In the analysis one or several variables are used, depending on the type of analysis.

Qualitative research usually emphasizes words rather than quantification in the collection and analysis of hard data. As a research type it is inductive and interpretive. Main methods used in qualitative research are participant observation, qualitative interviewing, focus groups, language based approaches to the collection of data (conversation analysis.

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13 Cooper & Schindler 1998, p 18
14 Bryman 2001, p 20
15 Bryman 2001, p 20
discourse analysis) and qualitative context analysis of documents.\footnote{Bryman 2001, p 264-266} The following table gives a systematic explanation of these two research types:

<table>
<thead>
<tr>
<th>Quantitative</th>
<th>Qualitative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Numbers</td>
<td>Words</td>
</tr>
<tr>
<td>Point of view of researcher</td>
<td>Points of view of participants</td>
</tr>
<tr>
<td>Researcher distant</td>
<td>Researcher close</td>
</tr>
<tr>
<td>Theory testing</td>
<td>Theory emergent</td>
</tr>
<tr>
<td>Static</td>
<td>Process</td>
</tr>
<tr>
<td>Structured</td>
<td>Unstructured</td>
</tr>
<tr>
<td>Generalization</td>
<td>Contextual understanding</td>
</tr>
<tr>
<td>Hard, reliable data</td>
<td>Rich, deep data</td>
</tr>
<tr>
<td>Macro</td>
<td>Micro</td>
</tr>
<tr>
<td>Behaviour</td>
<td>Meaning</td>
</tr>
<tr>
<td>Artificial settings</td>
<td>Natural settings</td>
</tr>
</tbody>
</table>

Table 1: Common Contrasts Between Quantitative and Qualitative Research

Source: Bryman 2001 Social Research Methods, page 285

In this thesis mainly qualitative methods are used in both data collection and analysis. Regarding data collection, authors have chosen to apply to semi-structured interviews as primary data in addition to secondary data. Analysis will be undertaken by qualitative content analysis, which will be done by going through the findings from interviews and secondary data. Since the thesis relies on only qualitative methods, possible negative effects of qualitative research need to be recognised and decreased. Commonly criticized features of qualitative research are subjectivity, difficulty of replication, problems in generalization and lack of transparency.\footnote{Bryman 2001, p 282} Other problematic issues with qualitative research are
access to reality, pre-understanding of the problem, and quality. In the conclusion part of this methodology, the authors outline the issues through which the negative effects of those factors to the outcome of this thesis were be decreased.

2.3 Data Collection and Analysis

The two main types of data, primary data and secondary data both have advantages and disadvantages but can also support each other when gathered and analysed in a right way. Primary data is information collected for the specific research by the researcher conducting the study. This offers a chance to collect just the kind of data that is needed for the analysis. Secondary data on the other hand is previously collected, by someone else and for other purposes than the research in question.18

2.3.1. Collection of primary data

Interviews were chosen as a tool for primary data collection in this study. Interviews are one of the methods often used to gather primary data in qualitative study. Other possible methods can be mail- or internet-surveys, observations and focus groups. The research period for this thesis started on 19th November 2004 and the last deadline give is January 12th 2005. A set of semi-structured personal interview questions was prepared for interview meetings.

Interviews can be conducted via telephone or other intermediate devices or personally, also called face-to-face interviews. The respondents can offer important information in conversations initiated by the interviewer. If carried out successfully, personal interviews are an

18 Cooper & Schindler 1998, p 256
excellent way of collecting primary data. The interviewer has more control in a face-to-face situation and the method offers flexibility during the interview. This method can also be costly and time-consuming. As with all the forms of interviews, the interpretation made by the researcher play a significant role for analysing the answers in a correct way.\footnote{Cooper & Schindler 1998, p 291}

Interviews can be divided into three main types, which are structured, semi-structured and unstructured interviews.

1 - Structured interviews are sometimes called standardised interviews and mostly used in quantitative research. The questions in such interview are usually very specific and close-ended, which means they offer the interviewee a fixed range of answers. The aim of such interview is to give to all interviewees exactly the same context of questioning, ensuring comparability and standardisation.\footnote{Bryman 2001, p 107}

2 - Unstructured interviews are the interviews, where the interviewer has with him/her only a list of issues, often called an interview guide. The style of questioning usually is informal. The sequencing and content of questions varies from interview to interview. The unstructured interview tends to be very similar to a character of a conversation. It can even consist of a single question, followed by questioning the important responses.\footnote{Ibid, p 314}

3 - Semi-structured interviews are those, where interviewer has a series of questions in a general form. Also the interviewer has some latitude to ask further questions in response to what are seen as significant replies.\footnote{Ibid, p 110} Mostly, all questions in the interview schedule are asked and a similar wording is used from interviewee to interviewee.\footnote{Ibid, p 314}
There are many reasons why the semi-structured interviews were chosen for this thesis; the main reason is its flexibility for interviewees. There were also other reasons for choosing this type of interview. In the beginning of this thesis process, when authors had to prepare interviews and conduct them, the purpose and research focus was fairly clear; there was a general notion on the European airline market topic but only after the interviews the thesis took a strong concentration on alliance strategies. Also, since authors were writing together, semi-structured interviews could ensure a needed level of comparability. The same set of questions with the exact same wording (in English language) was used in both interviews.

It must be mentioned that, the selection of companies for interview was not random. Rather, it was dependent on the accessibility and communication. Since it was authors’ desire to conduct personal interviews with managers or representatives of both Star and oneworld alliances, Finnair and SAS Group alliance managers were chosen as the two interviewees. The fact that Finnair and SAS Group represented different alliances makes interviews more comprehensible and reliable.

A pair of personal face-to-face interviews was conducted during the December 2004 in attempt to find out how these airlines see their future strategies and how the ones they have used have turned out. As respondents to these interviews Alliance management of member airlines was considered to be most compatible, since these managers are aware of the business situations not only internally, but also throughout alliance and even to some extent competitors in Europe. The respondents’ willingness to answer questions, expertise in the area and cooperativeness are important characteristics for a successful interview. In this research both respondents were very cooperative, friendly, professional and offered valuable data.
The first respondent is a Finnair Director, oneworld alliance and the second a SAS Group Vice President, Alliances. SAS is a member of the Star alliance so these respondents can offer insights to two large international airline alliances. The third, and newest, European alliance SkyTeam is not represented in this study but the two others do cover a major part of airlines operating in the European market.

One reason for the selection of respondents was access, since the resources of researchers were limited so the interviews needed to be conducted in Sweden and Finland. Face-to-face interviews allowed more discussion than telephone interviews and respondents gave much more information than only answers to the pre-assigned questions. Respondents were sent the interview questions in advance. Most questions were open-ended giving respondents room to choose how they answered them and motivate their answers.

In the empirical chapter answers of both respondents are reported separately. Data from the interviews can include material from discussions; not only by the pre-designed questions, and some additional information from the interviews will also be presented in the analysis part when comparing the data.

2.4.2. Collection of Secondary Data

Secondary data is very important in research, because it helps to decrease the subjectivity of primary data and to relate result to the reality in a relevant way. Sources of secondary data include company reports such as annual statements, but also public sources such as trade publications, industry reports, professional associations, media, published books etc. Use of secondary data has both advantages and disadvantages. The main advantage of secondary data is the availability. Data can be found quickly
and inexpensively. Collecting primary data sometimes can be so costly and time consuming that it becomes impractical.\textsuperscript{24} In this case collecting data from different sources for comparison supports the empirical data in analysis but also created general understanding of the market. The biggest disadvantage of secondary data, even if it would be gathered from reliable, original sources and be as recent as possible, is that it is still always gathered for other purposes than the research in question.

The data might also be outdated. If variables aren't exactly the ones needed, data can be manipulated and transformed in a way that might lessen the validity of the original research.\textsuperscript{25}

To prepare this study secondary data from various sources is used. Several published books as well as articles from business strategy and aviation journals were searched for information about European air-travel market (Journal of Air Transport Management formed an important source) and the particular alliances and airline companies of interest. To create deeper understanding of particular companies’ strategies, annual statements, the auditor reports and Internet pages are referred. The aim is to give the concise analysis of secondary data reports.

\textbf{2.4.3. Analysis of Data}

The analysis provides an understanding of the current situation and problems in European airline companies’ strategies and how alliances help member airlines to survive in the competitive market. As said above, qualitative methods of data analysis are used. In first stage, the method used in analysis is a qualitative content analysis of the answers of the respondents from the selected companies. In the second stage, qualitative content analysis of annual reports, statements and other secondary sources

\textsuperscript{24} Cooper & Schindler 1998, p 256-257
as well as personal interviews, is prepared. Related figures of company 
statistics are compared. This analysis comprises a search of underlying 
themes in the materials analysed. The material will also help in giving 
useful recommendations for future strategies.

**2.5. Validity and Reliability**

There are various types of criteria for evaluating a research, 
depending on in which field it has been conducted. For example, for 
research in social science the criteria of replication (replicable)\(^{26}\) is 
important, or for research conducted in business area, the criteria of 
practicability\(^{27}\) can be required. But the most prominent criteria for the 
evaluation of all kinds of research are validity and reliability.

**Validity**

In many ways, the most important criterion of research is 
validity. Validity refers to the extent to which the measures used in a 
research actually represent what the researcher wanted to measure.\(^{28}\)

*Internal validity* of a study means that the research is carried 
out according to the rules of good research practice and that researcher had 
correctly understood and analysed the phenomenon. *External validity* 
means that the results of a study can be generalized beyond the specific 
area of the research, in other words, it is possible to transfer the findings to 
other situations.\(^{29}\)

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25 Cooper & Schindler 1998, p 256-257
26 Bryman 2001, p 76
27 Cooper & Schindler 1998, p 174
28 Cooper & Schindler 1998, p 166
29 Bryman 2001, p 272
Two face-to-face interviews were conducted with managers of airline companies, alliance administration. Before interviews, secondary data was gathered by overviews of the companies and alliances’ web pages, several official information sheets and previous interviews. This helped to understand the current situation presented in the official information and to plan the questions needed in interviews for achieving validity in findings. Moreover, in analysis of data, critical approach is applied and comparisons used widely. Only critical approach can eliminate the formal nature of official statements, and give the thesis validity. With stating that the findings of this thesis study as well as analysis measure the strategic situation in European air-travel market, the authors claim that this research is valid. The choice of respondents and the answers they gave, combined with secondary data, ensure that the information is valid, since it comes from original sources offering an insight to both two case companies as well as the alliances they are members of. The individual airlines that meet the criteria of a “traditional network airline” and the alliance strategies were what the researchers intended to study.

**Reliability**

Reliability deals with whether the measures and results of a study are consistent. It concentrates on stability of research procedure. The other name for reliability, mainly used by qualitative researchers, is dependability criteria.\(^{30}\) Reliability can be defined also by precision of research measurement, whether the same result could be obtained on re-measurement.\(^{31}\) The ways to improve reliability include the motivation and integrity of researchers, broad sample of both secondary and primary data sources and

\(^{30}\) Bryman 2001, p 272  
\(^{31}\) Bryman 2001, p 70
by questionnaire design (the questions must be understood in the same way by all respondents, they are clear and there is no room for misunderstanding, a standardized set of questions is used in all primary data collection).\textsuperscript{32}

The reliability in qualitative studies is dependent upon the beliefs and values of researchers. The reason is that, researchers have more freedom for explaining and analysing the findings and presenting the outcomes. However, authors of this thesis did their best to minimize the influence of such “soft” issues (beliefs, values, norms) to reliability of presented study. For this reason, the same structure of personal interview was used in both interviews and the questions had the exact same wording. Especially the information from the interviews was analysed by each author separately and then compared, to prevent the subjectivity and misdirection.

In order to increase the reliability of the thesis, authors have described the data collection and analysis process in-depth, introducing the methods used to complete this thesis. Therefore, authors’ belief is that, if any other research study is conducted in the similar topic and area of interest, and same methods and documentation is used, then the result will probably be similar to what is presented in this thesis.

\subsection*{2.6. Method Criticism}

There are nearly no perfect research designs. Some of the imperfections may have little effect on the validity and reliability of the results of research, while others may invalidate them entirely. A competent researcher should be sensitive to the effects of imperfect design, and

\textsuperscript{32} Cooper & Schindler 1998, p 173
researcher’s experience in analysing the data should provide a basis for estimating their influence.

As authors we are aware that there might be some problems, which can lead to errors in analysis part and accordingly in the recommendations. Use of qualitative methods for analysis of the data result in some problems, such as subjectivity in recommendations, difficulty to replicate the findings, and problem in generalization of conclusions. It is clear that, the data collection process might mislead the analysis process, accordingly the recommendations since choices have to be made and secondary data presented in relation to the scope of the research.

Authors have chosen one airline company from each of the two alliances studied, namely SAS Group from Star alliance, and Finnair from oneworld alliance. This can cause the problem of generalization arising from the fact that SAS Group or Finnair might not represent the alliances as a whole well enough, so we cannot generalise the findings to cover the alliance level. However, membership criteria of the alliance is very strict for airlines, and considering the customer value and services they offer to the passengers, authors assume that there are not much difference between member airlines of any alliance. Therefore, authors do not believe that selection of only one airline from each alliance would cause any negative effects on analysis.

A research on more than two airlines would not have been possible in the time limitation of this study and author’s believe that concentrating on two cases can offer deeper analysis of these companies. The deeper look into a company level strategy offers insights to differences between airline companies instead of a more superficial industry level research. In this way the authors attempt to increase the practicability of the study, usefulness for companies and offering students a deeper understanding of strategy in this type of companies.
Another negative effect is the subjectivity. It is natural for all qualitative researches and cannot be avoided since all researchers are human. However, additionally to interview answers authors used a lot of journal articles and previous interviews. Therefore, it is believed that additional secondary material would decrease the subjectivity in analysis process.

It is very difficult to predict the future for an industry constantly in change; this is why descriptive style was chosen. The authors believe that giving a current, industry-wide description of the present industry and decisions that companies have made can benefit to the knowledge for future patterns. For a deeper look into the strategy process of airlines, the case companies were chosen and the alliance representatives interviewed. This anyhow does not present the reasons behind strategic decisions. Also the two companies are both based in the Northern European market and the results might not be similar to those in more intensive competition in busy international hubs such as London or Paris.

Even though the case companies both operate from the home market of Northern Europe, their organisational structure and operations are very different. The author’s believe that this makes the findings for these two companies more interesting and helps to generalise the results to the industry level. The companies are comparable according to the standards of network strategy, which means they do not possess similar market positions but similar network relationships.
3. Theoretical Framework

In this part, particular theoretical concepts will be presented and connected together in order to create a theoretical basis for understanding the strategic actions that full-service airlines have made for overcoming the industry challenges, their perceptions of customer value and benefits of alliance membership. Therefore, general introduction to the business strategy is introduced in the beginning of the chapter. Afterwards, specific theories of competitive advantage, strategies that lead to competitive advantage, concepts of industry analysis, value chain, customer value and network strategy are presented.

The authors have decided to apply Michael Porter’s general theoretical concepts of competitiveness and industry in order to fulfil the purpose, to analyse what strategic decisions the European traditional airlines have made during the downturn in the industry. The selection criteria for theories were the success and sustained acceptability of M. Porter’s concepts. The authors of this thesis believe in applying the original source of theories. The network strategy suggests that when comparing competitiveness, the companies’ network position should be studied instead of the position in the market as a whole. Some current articles and materials support the main literature used in this part.

3.1. Creating Business Strategy

Strategy can be defined in many ways and often in companies it means only an executive agenda that is seen every year in the annual budget and reports. Still strategic thinking should be more practice creating
shared vision and organisational purpose than management theory.\textsuperscript{33} Michael Porter’s identifies the core of strategy: \textit{“It is a combination of the ends for which the firm is striving and the means by which it is seeking to get there”}.

Source: Porter 1980, Competitive Advantage

The process of strategy creation is a very complex one. It includes strategic thinking, strategy formation and strategic change.\textsuperscript{34} Strategic thinking includes two elements that are the driving forces of a company: future intention (long-term view) and sources of advantage (how best to compete). The targets and how to get there should be planned together.\textsuperscript{35}

Skat-Rordam has identified different levels of strategic thinking, action and learning processes. These levels will shortly be presented in order to create understanding of the strategic processes this thesis concentrates on. All of the levels are important in a changing and highly competitive industry environment of today. They also present a realistic view of practical strategic processes, not only creating statements of company visions, missions and future (optimistic) goals.\textsuperscript{36}

Looking behind the symptoms of the industry is the first step. In the business world the reactions and solutions to problems within an industry need to be fast and analysis of what caused the problems is often forgotten. This is anyhow where strategic thinking is especially needed. Understanding the needs of the customer is very often required for successful new ideas. Managers need ability to see synergy opportunities when they arise, not only between different companies but also internally creating work groups with people that have different backgrounds and

\textsuperscript{33} Kare-Silver 1997, p 2
\textsuperscript{34} De Wit & Meyer 2004, p 7
\textsuperscript{35} Kare-Silver 1997, p 19
\textsuperscript{36} Skat-Rordam 1999, p 54-47
competences. Timing is everything and even a good strategy does not work if it is launched at wrong time in an industry development. Strategy should always include two dimensions, short- and long-term; it should not only create visions and goals for the distant future.37

Selection of a new strategy is a difficult task that creates disagreements inside the company but bad compromise is not a good choice. Selling the new strategic ideas to stakeholders is an important step to the management of a company, the new direction has to be seen as better than the present situation. New strategies and business areas always involve ability to take risks that can create great revenue if successful. Experimentation of a strategy in a small scale in the first phase can save the company from taking too big of a risk.38

Control over the strategic decisions is necessary, not only based on numbers and tables but reactions and customer feedback. Constant follow-up and refining of strategies, when ever necessary, can identify new threats and opportunities better than in formal annual strategy sessions. Learning from mistakes can be done only when a mistake has been identified and admitted.39

The formation of strategy includes two simultaneous processes: the implementation of planned strategy and emergence of incremental strategy. Mintzberg and Waters first introduced this division in 1985. The division means that in the business process a company implements its planned strategy. However, as industry evolves and changes, company has to adapt to the competitive environment and fit to the industry requirements. From this point, the emergent strategy becomes inevitable. Emergent strategy diffuses with the deliberate strategy and they

37 Ibid, p 54-57
38 Ibid, p 54-57
39 Skat-Rordam 1999, p 54-57
form out realized strategy of the company.\footnote{De-Wit and Meyer 2004, p. 111-113} This process can be clearly seen from the following chart:

![Figure 1: Deliberate and Emergent Strategy\footnote{Cited in De-Wit and Meyer 2004, p. 111}](source)

The overall purpose of business strategy is to become able to survive in the competitive industry. Therefore, sometimes the business strategy is called as competitive strategy. The competitive strategy for managers is the strategy, which allows the company to align the current, and potential strengths and weaknesses of the organization with the current, and potential opportunities and threats in the environment.

Identifying the industry and especially segmentation of the customers is very important in strategy formulation process. In the following chapters, the concepts of customer value and competitive advantage will be explained.
3.2. Competitive Advantage

“Always to be the best and to be distinguished above the rest”

Source: “The Iliad”, Homer (8th century BC); Greek poet.42

In very short, competitive advantage could be described as the advantage that company achieves against its competitors in the industry. It grows fundamentally out of the value a company is able to create for its customers. It might take the form of prices lower than competitors’ for equivalent benefits or the provision of unique benefits that more than offset a premium price.43

Broadly speaking, in order to be successful, companies need to achieve enough power to counterbalance the demands of buyers and suppliers, to overwhelm competitors, to keep off new firms from entering the industry/market and to fend off the threat of substitute products/services. If company achieves to realize these plans, then it is said that company has competitive advantage over its rivals in particular industry/segment. Preferably, the competitive advantage should be sustainable to guarantee superior results within the prolonged period of time.44

Competitive advantage could only be achieved if the company creates superior value for customers. Sustainable competitive advantage is the only way for surviving in the industry and getting benefits in the long run. Competitive advantage is said to be sustainable if it cannot be copied, substituted or eroded by the actions of competitors; and is not made redundant by developments in the industry. As De Wit and Meyer present,

42 Cited in De Wit & Meyer 2004, p 231
43 Porter 1985, preface p XXII
44 De Wit & Meyer 2004, p 231
sustainability depends on two main factors: competitive defend ability and environmental consonance.\textsuperscript{45}

Competitive advantage could be achieved and sustained only by implementation of generic strategies. They are Cost-Leadership, Differentiation and Focus strategies. The three generic strategies will be further discussed later in this chapter. Because the competitive advantage is rooted in a unique business system\textsuperscript{46} (resource base, activity system, product/service offering), it is very useful to look at the concept of value chain, where competitive advantage of company often comes from.

### 3.3. Value Chain

Competitive advantage cannot be understood by looking at the company on a general level. It emerges from different activities, which company performs in designing, producing, marketing, delivering and supporting its product/service. The analysis of value chain is fundamental for identifying the sources of competitive advantage and the generic strategies.\textsuperscript{47}

The value chain divides a company into its strategic activities in order to understand the cost behavior and potential sources of differentiation. Porter suggests nine types of activities, which form the value of the company’s product/service, and positions them in the chain as primary and support activities.\textsuperscript{48} This can be seen from the Figure 2. A company gains competitive advantage by performing those strategic activities in more cost effective way or better than its competitors.

\textsuperscript{45} Ibid, p 244  
\textsuperscript{46} Ibid, p232  
\textsuperscript{47} Porter, 1985, p 33
Primary activities listed in the chart, are the activities physically/directly involved in the creation of the product/service, and its sale and transfer to the customer as well as after-sale assistance. In contrast, support activities support the primary activities and each other by providing purchased inputs, technology, human resources and various company-wide functions.\(^{49}\)

The generic primary operations that Porter identified in all companies are inbound logistics, operations, outbound logistics, marketing & sales and after-sales services. The generic support operations to these primary operations that are not dependent on industries he named as infrastructure, procurement functions, human resources management and technological development.\(^{50}\)

In each subcategory of value-adding activities, there are three types\(^{51}\) of activities:

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\(^{48}\) Ibid, p 37  
\(^{49}\) Ibid, p 38  
\(^{50}\) Albers, Koch & Ruff 2004  
\(^{51}\) Porter 1985, p 44
1 – Direct activities: these are directly involved in creating value for the buyer, such as assembly, parts machining, sales operations, advertising, recruiting etc.

2 – Indirect activities: these make it possible to perform direct activities on the continuing basis, such as maintenance, scheduling, sales force administration, research administration, vendor record keeping etc.

3 – Quality assurance activities: these ensure the quality of other activities, such as monitoring, inspecting, testing, adjusting, reviewing etc.\textsuperscript{52}

Value chains could be constructed for companies, as well as segment-wide, even industry-wide. Differences among competitor value chains are a key source of competitive advantage.\textsuperscript{53}

Value chain could be affected by competitive scope. Considering that competitive scope includes segment; vertical; geographic; and industry scopes,\textsuperscript{54} for this thesis it is meaningful to focus on industry scope only. Potential interrelationships among the value chains of competitors are widespread nowadays. They can involve both primary (for example shared service or maintenance) and supportive activities (for example joint technology development). A shared logistical system may allow the companies to reap the economies of scale, while a shared sales force offering both products/services can improve the salesperson’s effectiveness with the buyer and thereby enhance differentiation.\textsuperscript{55}

Businesses with similar overlapping value chains are candidates for linkage opportunities. So, any company can get into coalitions with other companies to achieve some or all of the same benefits. In this context, companies are sharing some part of their value chain. For

\textsuperscript{52} Ibid, p 44
\textsuperscript{53} Porter 1985, p 44
\textsuperscript{54} Ibid, p 53
\textsuperscript{55} Ibid, p 53
example, they can incorporate their overseas offices in the same country, for sharing premises and sales forces, or if they are dependent on the similar components, they can coordinate their purchases and get benefits of that.\textsuperscript{56} Coalitions are long-term agreements among firms that go beyond normal market transactions, but stop outside of mergers. Coalitions are ways of broadening scope without broadening the company by sharing the value activities with another company. Coalitions are one of the popular means of gaining the cost or differentiation advantage, without actual merger.\textsuperscript{57}

3.4. Generic Strategies

After having an understanding about strategy and competitive advantage, the theoretical part of the thesis aims to present a framework for industry strategy as suggested by Porter. The generic strategies will be introduced and related to the customer value framework.

As Porter states, the main basis of company’s above-average performance in the long run is sustainable competitive advantage.\textsuperscript{58} He offers two basic types of competitive advantage: \textit{low-cost} and \textit{differentiation}. The significance of any strength or weakness a company possesses is ultimately function of its impact on relative cost or differentiation. When these two basic types of competitive advantage are combined with the scope of company’s activities, they lead us to \textit{three generic strategies} for achieving above-average performance in an industry. They are cost leadership, differentiation and focus.\textsuperscript{59}

\begin{thebibliography}{99}
\bibitem{De-Wit and Meyer, 2004, p 342} De-Wit and Meyer, 2004, p 342
\bibitem{Porter 1985, p 57} Porter 1985, p 57
\bibitem{Porter 1985, p 11} Porter 1985, p 11
\end{thebibliography}
When Network Strategy Is Not Enough – The Case of European Full-service Airlines

Competitive Advantage

<table>
<thead>
<tr>
<th>Competitive scope</th>
<th>Lower Cost</th>
<th>Differentiation</th>
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<tr>
<td>Broad target</td>
<td>1. Cost Leadership</td>
<td>Differentiation</td>
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<tr>
<td>Narrow target</td>
<td>3A. Cost focus</td>
<td>Differentiation focus</td>
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Figure 3: Porter's Generic Strategies

Source: Porter 1985 “Competitive Advantage” page 12

The framework of Michael Porter is still widely used in strategic analysis, even after some criticism and the fact that the theories were created in the 1980’s. The generic strategies presented the idea that ultimately even in various industrial situations there are only few strategic options. His generic strategies are industry-wide, un-segmented and manufacturer driven, rather than starting from market demand and customer needs. In his theories, supplier holds the power in the industry balance competing with other suppliers. Since then responding to customer demands has become a necessity not an option. Porter also gave understanding to the aspects of the value chain, with which activities a company can create value in more competitive way than competitors. In many ways Porter’s strategies have been run over by the realities of today’s markets. He has stated himself that the lowest cost strategy does not apply as such anymore when economies of scale is being destroyed by the pace of change and small companies are winning in low-cost strategy over larger ones. 60

In practise the generic strategies are too superficial to offer insights the competitive advantage that drives performance. The theory can

59 Porter 1985, p 11
60 Karel-Silver 1997, p 45-48
create background and understanding of the present situation in whole of the industry but cannot be used by managers in decision-making for future market dynamics. In his later writings Porter talks about focused differentiation instead of trying to compete across the industry. In today’s industries most companies are forced to focus on particular customer segments since industry-wide differentiation is unlikely to be achieved.  

3.4.1. Cost Leadership

Cost leadership is perhaps the clearest of the three generic strategies; by this strategy company tries to become the low-cost producer in the industry. The scale of the company is very important in reducing cost and becoming cost-leader. Therefore, companies that seek cost leadership mostly have broad scope, and operate in many industry segments, in related industries. The strategic logic of cost leadership usually requires that, company must be the cost leader, not one of the several companies rivaling for this position.

Cost advantage results if the company achieves lower aggregate cost of performing value activities than its competitors. Cost analysis start in company’s value chain, and seeks for how to assign operating costs and assets to value activities. This is due to fact that, the amount of assets in particular activity and the efficiency of asset utilization are important to the activity’s cost structure. So, it is possible to imply that, a company has cost advantage if its aggregated cost of performing all value-adding activities is lower than competitors’ costs. Cost advantage leads to superior performance if the company provides an acceptable level

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61 Ibid, p 47-49
62 Porter 1985, p 12
63 Porter 1985, p 64
of value to the buyers so that cost leadership can provide sustainable competitive advantage.

According to Porter, company’s relative cost position is a mix of: The compositions of its value chain versus competitors’ and its relative position vis-à-vis the cost drivers of each activity. There are two major ways that a company can gain a cost leadership advantage:

- Controlling cost drivers: the cost advantage could come with respect to the cost drivers of value activities representing a significant proportion of total costs.
- Reconfiguring the value chain: Company could adopt a different and more efficient way to design, produce, serve, and distribute the product. ⁶⁴

Low-cost production also leads to the attempt to achieve competitive advantage through pricing. There are success stories of companies that have concentrated on offering low prices; some even made it their main strategic focus. For many other companies pricing is a difficult area. ⁶⁵

Many companies feel that pricing is out of the hands of the company itself and that the information needed about the markets and competitors is hard to find. These are the reasons why pricing is often not considered strategically. ⁶⁶

### 3.4.2. Differentiation

Differentiation is one of Porter’s generic strategies for achieving competitive advantage. A company differentiates itself from its competitors, in terms of uniqueness at something that is valuable to customers. In this regard, company acts in a horizon that is beyond simply

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⁶⁴ Ibid, p 99
⁶⁵ Kare-Silver 1997, p 164-165
⁶⁶ Kare-Silver 1997, p 167
offering a low price. The extent of differentiation is different from industry to industry.⁶⁷

It must be understood that, being unique does not mean differentiation: it must also be valuable for customers. That is reason why various companies fail to possess competitive advantage, simply because they fallaciously think about differentiation and do not care about how much is their product/service is valuable to customers. Another reason of failure of companies is that, they pay insufficient attention to the cost of differentiation.⁶⁸

Differentiation is usually costly. A company that wants to get a competitive advantage by differentiating itself from competitors must often incur additional costs. These additional costs emerge due to the attempt to perform activities better than competitors. The get an understanding of the cost of differentiation, a company must compare the cost of being unique in particular activity with the cost of being equal to the competitors. So, it will not be wrong to say that, if a company has been aggressively cutting off its costs, then, attempts to achieve uniqueness usually raise total cost. However, in some companies differentiation factors, such as integration of activities or company scale innovation, can lower cost, simultaneously making the company differentiated. It could have several reasons according to Porter:

- Company has not been fully exploiting all the opportunities to lower cost;
- Being unique in an activity was formerly judged undesirable;

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⁶⁷ Porter, 1985, p 120
⁶⁸ Ibid, p 160
- A significant innovation has occurred, which competitors have not adopted: it both lowers cost and improves quality.\textsuperscript{69}

It should be mentioned that, both low-cost and differentiation strategies are interrelated. The low-cost leader company should provide the minimum level of quality or standards for product/service, so that quality matters will not nullify the effect of price advantage. On the other hand, if the cost of differentiation is very high, then price of product/service should be considered, whether it is reasonable or not comparing with the competitors’ prices.\textsuperscript{70}

\textbf{Sources of Differentiation}

Differentiation stems from the specific activities a company performs and how customers assess them.\textsuperscript{71} Differentiation could be achieved in any part of the companies’ value chain.

Any value activity, regardless of kind (material logistics, selling or human resources), is a potential source of differentiation. The main important issue in value chain is consistency and coordination. Differentiation could be achieved only in coordinated and linked activity system.

Successful companies create uniqueness through other primary and support activities. As Porter states, value activities even representing only a small percentage of total cost could have a major impact on differentiation. In his example, although inspection covers only one per cent of total costs, shipment of one defective package of drugs can have

\begin{flushright}
\textsuperscript{69} \textit{Porter 1985, p 129} \\
\textsuperscript{70} \textit{Ibid, p 13-14} \\
\textsuperscript{71} \textit{Porter 1985, p 120}
\end{flushright}
major negative repercussions for a pharmaceutical company’s perceived differentiation.\textsuperscript{72}

Drivers of uniqueness:
- Linkages within the value chain
- Channel linkages
- Learning and Spillovers
- Large Scale\textsuperscript{73}

3.4.3. Focus

The third generic strategy is slightly different than the other couple of strategies, because it relies on the selection of narrow competitive scope within the industry. The company selects one group or several segments from an industry and serves them, excluding other segments-groups. By optimizing its strategy in the target segments, “focuser” seeks to achieve the competitive advantage in those segments only, but not in the overall industry.\textsuperscript{74}

If the company can achieve sustainable cost leadership or differentiation in its segment and the segment is structurally attractive, then that company will be above-average performer in its industry. In this regard, segment structural attractiveness is a necessary condition because some segments in an industry are much less profitable than others.\textsuperscript{75}

The focus strategy has two types: cost-focus and differentiation-focus. With these strategies, the company tries to get either cost advantage or uniqueness advantage in the selected segments. Both types of focus strategy rely on differences between the focuser’s target

\textsuperscript{72} Porter 1985, p 121
\textsuperscript{73} Ibid, p 121
\textsuperscript{74} Ibid, p 15
\textsuperscript{75} Porter 1985, p 16
segments and other segments in the industry.\textsuperscript{76} Cost focus exploits differences in cost behavior (more efficient production and delivery system) in target segments, while differentiation focus exploits the special needs of buyers in certain segments. Such differences imply that, broadly targeted competitors poorly serve these segments and the focuser can achieve competitive advantage by dedicating itself to these segments. If the focuser’s target segment is not much different from other segments, then the focus strategy will not succeed.\textsuperscript{77}

When speaking about generic strategies, it is important to mention the term of “stuck in the middle”. The term refers to companies, which adopt both broad generic strategies (cost leadership and differentiation) but fails to implement any of them. They try to find competitive advantage through every means and achieve none, because achieving different types of competitive advantage usually requires inconsistent actions. A company, which is stuck in the middle, will operate with below-average performance, because the cost leader, differentiators and focusers will be better positioned to compete in any segment.\textsuperscript{78}

\subsection*{3.5. Industry Analysis}

Structural analysis is a powerful tool for determining profitability of particular industry. Industry analysis concept was first introduced by M. Porter. According to him, the first determinant of company’s profitability is industry attractiveness.\textsuperscript{79} In any industry, whether it is domestic or international, or produces a product or a service,
the rules of competition are determined by five forces as presented in figure 4.

![Figure 4: The Five Competitive Forces of an Industry](source)

The strength of these five forces varies from industry to industry, and can change, as the industry evolves. Thus, the strength of each of the abovementioned forces is a function of industry structure that is the underlying economic and technical characteristics of an industry. Therefore, for better understanding of the concept, explanations of each of these forces are given in the following:

**Suppliers** - The bargaining power of suppliers determines the costs of raw materials and other inputs.

**Buyers** - Buyers’ bargaining power influences the prices that company can charge. It has similar effect on the prices than substitutes. The power of buyers can also influence cost and investment, because powerful
buyers demand costly service.\textsuperscript{80} In industries, where switching between suppliers is not difficult, the bargaining power of customers (buyers) is very high.

\textbf{The rivalry} - The intensity of rivalry influences prices as well as the costs of competing in areas such as plant, product development, advertising and sales force. The rivalry in the industry depends on several factors:

- Number of companies and relative market shares
- Growth rates of the industry
- Degree of differentiation
- Level of fixed costs
- Economies of scale
- New owner/chief executive personality. \textsuperscript{81}

\textbf{The new entrants} - The threat of new entrants sets a limit on prices, and also shapes the investment required to deter the entrants. New entrants to the industry are very important in competitor analysis, because they are difficult to predict. There are four types of possible new entrants:

- Organization that are in the industry already, but in a different parts of the world.
- Organizations that are in closely related businesses.
- New businesses set up by individuals who have been employed in competitor companies and therefore already know the business. \textsuperscript{82}

According to Hussey and Jenster, there are mainly four factors that create the entry barriers to the industry and make new entries very difficult:

- A high level of differentiation

\textsuperscript{80} Porter 1985, p 5
\textsuperscript{81} Hussey & Jenster 1999, p 44
\textsuperscript{82} Hussey & Jenster 1999, p 49
• Patents
• The cost structures of the companies in the industry
• Additional to patents, other factors which make it difficult for new entrants to position themselves in a particular market. These may be government restrictions.\(^83\)

**Substitutes** - Substitutes are also important part of industry analysis. They are those products/services from other industries, which can satisfy almost the same needs. Therefore, when making industry analysis, substitutes should certainly be taken into consideration.

Although Porter’s Five Forces model is still valid, there have been a lot of studies conducted on the basis of this model. In one of these, Hussey and Jenster improve the model by dividing the barriers into entry and exit barriers, and introducing completely new “influencers” force between buyers and industry collaboration.\(^84\)

Traditional theories structure the industry by level of concentration, strategic groups, market power between upstream and downstream industries, the entry of new competitors and entry barriers. This can be clearly seen in the five forces theory by Michael Porter. A network approach attempts to create a more refined view of industry structure in which resources, information and other networks affect the nature of competition within the industry. Traditional theories have not been able to show these differences in profitability that can be explained by types of network relations that are found in the industry, characteristics of members in networks and by understanding norms of appropriate behaviour in the networks. These characteristics of common networks inside the industry can explain differences in companies’ profitability.\(^85\)

\(^{83}\) Ibid, p 49  
\(^{84}\) Ibid, p 43  
\(^{85}\) Gulati, Nohria & Zaheer 2000
Strategic groups and clusters have been identified in industry analysis also before by finding similarities between companies. Network relations can explain the barriers for companies to move from one strategic group to another inside the industry. Networks can create both opportunity and constraint in the industry based on similarity in network position instead of company attributes.  

3.6. Network strategy

3.6.1. Inter-Organisational Relationships

Strategic research has tried to find different solutions to why companies succeed and if differences are external (created by the market or industry environment) or internal and resource-based. In today’s business environment all companies are involved in multiple social, professional and exchange relationships and form networks including strategic alliances, long-term buyer-supplier relationships and joint ventures. These networks have a significant strategic importance. Relational approach suggests that understanding the networks that companies are involved with creates understanding of the performance.  

Strategic decisions are not only made inside the companies on a corporate level but also there is interaction between companies, networks and agreements are formed. The important issues for network level strategy are which are the potential counterparts that a company could create a relationship with, why do the parties wish to have a relationship with each other, what type of relationship can be formed and what factors affect the

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86 Gulati, Nohria & Zaheer 2000
87 Gulati, Nohria & Zaheer 2000
selected form, and finally how will the agreement be structured in order to achieve desired functions.\(^88\)

Companies can form relationships within the same industry or with contextual actors that create supportive performance to the core value. Partners can be found among the rivals within the same business, this is called a horizontal relation. Relationships and agreements with representatives of buyers or suppliers are called upstream and/or downstream.\(^89\) The different organisational forms of agreements between companies can be types of networks, partnerships or alliances. Contractual agreements have a clear established legal enforceability while non-contractual co-operations are not legally binding. Both structures are formed between two financially individual partners, not taking financial responsibility of each other or a joint venture. In equity-based agreements there is a financial stake to the parties. Another way of classifying the types of agreements is to look at the partners involved. Bilateral agreement is made between two parties while multilateral involve three or more parties.\(^90\)

There are different parties that companies must interact with and they can be divided into eight major groups. Of these groups four are individuals or organisations with value-adding activities or affect the outcome of these activities, the industry actors: suppliers, buyers, industry insiders and industry outsiders. The main categories of the relationship types between industry parties are:

- *Upstream vertical relations*

  Every company has supply relations to providers of materials, machinery, technology, services, information, land, labour or capital.

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\(^88\) De Wit & Meyer 2004, p 360
\(^89\) Ibid, p 360
\(^90\) Ibid, p 366-367
These can be intermediate agents or producers. First-tier suppliers are the ones in direct contact with the company but there might be other suppliers involved further upstream.

- **Downstream vertical relations**
  Contact with the buyers. Customers can be the end users or intermediates. Also these relationships can affect more layers downstream than the immediate party.

- **Direct Horizontal relations**
  These are contacts within the same industry, to competitors that offer same type of products or services.

- **Indirect Horizontal relations**
  These are relationships to parties outside the industry competition, usually producers of additional / complimentary products and services or substitutes. Another possibility is a contact to possible new entrants, where companies can assist or prohibit another company in entering the same industry.  

The other four groups consist of actors that create conditions in which the industry actors operate, the contextual actors: socio-cultural actors (parties that strongly form the values norms and beliefs within the society, including media), economic actors (parties influencing economic environment where the companies operate, tax offices, stock exchanges and unions), political/legal actors (parties that have the power to set regulations under which the companies in the industry must operate, international institutions, political parties) and technological actors (parties that affect the development of technology, innovations, patents, for example universities).

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91 De Wit & Meyer 2004, p 360-361
92 De Wit & Meyer 2004, p 361-362
Relationships between companies and their development is dependent on many factors such as power that each party holds within the industry, ability to influence others, resource dependency, future expectations, frequency of the contacts, timing of contacts, written and unwritten contracts or codes, trust between organisations and what is considered as appropriate behaviour or opportunism. Depending on these and many other factors companies form both loose and tight relationships where the power structure can vary from unbalanced dependency to mutual relationships of equally independent partners. Figure 5 shows the network of relationships between the company and both industry actors as well as supportive actors.

Figure 5: A Company and Its Relational Actors

Source: De Wit & Meyer 2004, p 361

Companies involved in organisational networks can form different types of collaborative agreements, bilateral agreements between

93 De Wit & Meyer 2004, p 364-365
two partners or multilateral between three or more parties. The aim is to benefit from vertical or horizontal integration with least possible costs. Still individual companies are not tied to the hierarchy and can make several agreements at the same time with different partners. Companies cannot isolate themselves from others but need to constantly be seeking to work with them in different relationships both inside and outside the industry to obtain mutual benefits.  

Traditionally strategic research has looked for models of competition that focus on scale, advertising, product similarity or differentiation and interdependence in value chains (for example Michael Porter in Generic Strategies and Value Chain). The companies’ positions within inter-organisational networks have been somewhat overlooked in competitive strategy. The network approach suggests that for competitiveness, companies in similar positions in networks should be compared instead of ones holding similar market positions. Gulati, Nohria & Zaheer state that analysis of industries cannot be done today without analysing the network connection of companies in the industry.

Resource-based strategies have stated that resources that a company owns and controls can create competitive advantage if they cannot be easily imitated or substituted by competitors. Networks can offer the possibility to gain access to resources in the network environment, such as information, access, capital goods and services, which can help to maintain or increase the company’s competitiveness status. Each company has its unique structure of network connections that can also create great potential and be difficult to copy. Equally the network structure can drive the company towards undesired strategic position. The membership and choice of partners play an important role in achieving useful resources and

94 De Wit & Meyer 2004, p 367-369
95 Gulati, Nohria & Zaheer 2000
benefits from the network, while non-members and newcomers will be locked outside of new information or opportunities.  

### 3.6.2. Strategic Alliances

An alliance means a voluntary collateral contractual agreement between two or more companies for the purpose of improved long-term competitiveness that will lead to improvement in overall performance. Alliances have grown their strategic importance and today they are among the most important inter-organisational forms. Studies from recent years have shown that alliances do create economic value for member companies. At least in theory companies can benefit of synergies sharing each other’s core competences. Shared technology can create product feature, service and sales advantages as long as features are protected from imitation. For financial success must all members of the alliance be financially stable to be able to support the alliance. Even with potential for value creation about half of all alliances formed fail and therefore also create a risk for companies involved.

Joining an alliance network does bring benefits of joint planning and wider markets but it involves risks that need to be evaluated from a strategic point of view. Houlden lists following points for companies to keep in mind when joining an alliance:

- The membership should be well planned and benefits, costs but also contribution to the group must be evaluated.
- Timing and long-term strategy needs to fit together with the network.
- Price of entering an alliance is an important factor.

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96 Gulati, Nohria & Zahneer 2000  
97 Albers, Koch & Ruff 2004  
98 Kale, Dyer & Singh 2002  
99 Mockler 1997  
100 Kale, Dyer & Singh 2002
The alliance cooperation is not only about strategic fit and products that support each other; it also combines organisational cultures, information and control systems, philosophies and behavioural aspects.¹⁰¹

Previous experience of cooperation and alliances has in research been shown to increase the possibility of success as well as the level of stock market returns. Companies can learn to manage network situation in their advance. Still it is not clear why some companies create better alliance capability than others. Kale, Dyer and Singh studied 78 firms involved in 1572 alliances to find out which organisational characteristics affects the alliances’ success. They suggest that companies can get more benefits and valuable learning experience from alliances if a specific “dedicated alliance function” is set with separate personnel and resources appointed for the alliance related issues. This can create more systematic learning from the alliance and in the case of dispute the alliance function can become a very important part of solving the problem. The investment in dedicated alliance function was found in this study even more important for creating alliance success than previous alliance experience of the company.¹⁰² For alliance success the future visions and plans of each member should be compatible. This affects the use of companies’ core competences and resources such as advanced technology.¹⁰³

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¹⁰¹ Houlden 1999, p 160-161
¹⁰² Kale, Dyer & Singh 2002
¹⁰³ Mockler 1997
3.7. Creating Customer Value

3.7.1. Understanding Customers and Market Conditions

A customer is an individual or a group on whose actions business success depends on. Co-operation between the customers and the company aims at satisfying needs. Customers expect to get some added value delivered by the company they are in contact with.  

Business strategies in practice must start from meeting the customers’ needs. Before customers could be seen as a large homogeneous group but strategic planning is needed to identify smaller customer groups. Serving different customer groups require different costs, potential competitive threats and opportunities. Customer group’s analysis offers companies possibilities to identify growth opportunities for the future.

Demand represent what the customers intend to buy in a geographic area. Demand meets supply in a market, a group of individuals and organisations that buy or intend to buy particular products/services. Market situations are constantly changing and must be closely monitored. Demand is usually not measured only as a whole but as different segments (groups that can be identified from the whole market with a clear set of characteristics) in order to estimate changes and trends in the market. If there is no demand the company cannot sell its products/services in that segment, “you cannot sell ice to Eskimos”.

Today the business environment is driven with different forces than at the time Michael Porter’s theories were born. Customer dynamics have become increasingly important, and winners are the ones who best understand what the customers want. Power inside the industries has

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104 Lahtinen & Isoviita 1994, p 5
105 Stern & Stalk 1998, p 125-126
106 Lahtinen & Isoviita 1994, p 59
shifted from the suppliers to customers, scale does not automatically mean success, technology develops fast and is copied easily, constantly new low-cost operators appear on the markets and at the same time global market area has made the control a difficult management task.\(^{107}\)

Multinational organisations have been slow to react to this change and adapt to each local area. There are still companies that assume customers do not know what they want; these organisations are not truly customer-oriented.\(^{108}\)

Customer relationship efforts can create loyalty and regularity in customer behaviour. Loyal customers are also good marketing and spokespeople for the company and products/services. An experience influences future behaviour and bad reputation spreads even faster than a good one.\(^{109}\)

Customer orientation can have a large impact on long-term profits for many reasons. Satisfied customers often place repeated orders, might be prepared to pay a higher price than new customers and even bring new customers along to the company with recommending its services. Regular customers decrease the need for attracting new customers and maintaining a customer base makes it harder for competitors to grow their market share or to penetrate the market.\(^{110}\)

Investing in service and customer relationships affect profitability because especially in the later years of customer relationships the amount of purchases tends to increase. It has been found in research that a five per cent decrease in customer turnover increases profitability on average by 55 per cent. This statement has become known as the 5/55 rule.\(^{111}\)

\(^{107}\) Kare-Silber 1997, p 22  
\(^{108}\) Ibid, p 25-27  
\(^{109}\) Lahtinen & Isoviita 1994, p 24  
\(^{110}\) Ibid, p 29  
\(^{111}\) Ibid, p 31
3.7.2. Customer Value

In literature customer value is often defined as the relationship between quality and price in the way a customer perceives them. The quality means how the customer sees the overall excellence of the product or a service. Price perceived by the customer’s is subjective view of what the objective price of the product should be. Another way of looking at the value creation from the company’s point of view is the relationship between the quality the customers perceive and the production cost.\(^{112}\)

Creating customer value should be recognized as an important element of the business strategy in any market-driven business. A customer should get more value for the product or service than when purchasing from a competitor and to achieve that the company obviously needs precise information about what do the customers value. The problem in many customer value studies is generalisation; that customers are seen as one big group of people affected by same conditions.\(^{113}\)

For companies that wish to differentiate themselves from competitors through service it could be beneficial to analyze the specific customer perceptions of each product/service characteristic. Setting a customer value chain and comparing it to the value chain of the company can show the areas that need to be changed in order to get the two value chains as similar as possible. Having results of which tangible actual characteristics customers’ value can have a positive economic effect for the business.\(^{114}\)

Different customers can value different characteristics of a product or a service. Today the customer expects more than the basic product function and quality in production. Convenience, ease of use and

\(^{112}\) Desarbo, Jedidi & Sinha 2001
\(^{113}\) Desarbo, Jedidi & Sinha 2001
\(^{114}\) Desarbo, Jedidi & Sinha 2001
less time needed, are desirable for most products and services. People are busy and they expect fast service. Speed means not only getting to the customers fast and satisfying their needs in a fastest way, but also helping customers to save time themselves. Convenience can also be seen in two ways, with easy to use products and services as well as enhancing lifestyle or business convenience.\textsuperscript{115}

3.8. Conclusion for Theoretical Framework

Business strategy is a process involving strategic thinking, planning, strategy formulation and implementation as well as changing and revising the existing strategy. The reason why this is important for companies is in short to survive in a competitive industry.

Michael Porter has introduced a well-known term of competitive advantage. This is an advantage that companies can create over their competitors by creating value to their customers. According to Porter there are two main strategies companies can choose between when trying to achieve competitive advantage, cost leadership and differentiation. The combination of these is not possible in his opinion. Companies that aim at differentiating themselves from the competitors need to know their customers and segment them into target groups to be able to create value.

For choosing the right strategy and creating competitive advantage, companies especially in highly competitive industries need to analyse the environment carefully. Industry analysis, using the five forces analysis, forms understanding of the company’s and its competitors’ relationships and positions in the industry. Understanding inter-organisational relationships help in creating strategy not only on company level but also between companies, forming networks. Bilateral agreements

\textsuperscript{115} Kare-Silver 1997, p 135-138
are formed between two companies while multilateral agreements include three or more parties. A strategic alliance is one of the multilateral agreement forms and has become increasingly important form of network strategy in many industries.

As a conclusion to the theoretical framework, the following figure presents the essential steps of companies’ strategic decisions relevant to this study and the industry in question.

![Figure 6: Conclusion for the Theoretical Framework](image-url)
4. Empirical Study

From general look at the market situation in Europe and the alliances operating in 2004 this chapter will target this thesis to the traditional airlines and strategic choices they have made. After combining secondary data from different sources, primary data from interviews will light the strategic decisions made in Finnair and Scandinavian Airlines. Other previous interviews are presented and compared to the primary information gathered for the purpose of this study.

4.1. Airline Strategy

4.1.1. The Past and the Present in the European Market

To understand the present situations in the industry, previous decisions, conditions and changes in market conditions need to be understood. This chapter offers the reader an insight to the development of the European market as a whole, introducing competition pressures that low-cost airlines have brought to the market and then analysing the market at present.

Traditional airline Strategies

Before the middle of 1990’s the airline business in Europe consisted mainly of state-owned national airlines that dominated the domestic routes within their country of origin. Many of these companies did not make great profit due to heavy organisational structures and high fixed costs.\textsuperscript{116}

In the middle of 1990’s the European airlines started to form networks based on hub connectivity. In this way airlines feed each other’s
hubs incoming customers who can continue on another outbound flight from the hub. Largest hubs with a lot of connecting flights by different airlines in Europe are located in London, Frankfurt and Paris. In the connection structure, on-time schedules are very important. The prices were high and differentiation of services especially for short flights was poor. Customers can get good connections but who wouldn’t want to fly directly to the final destination? For a while this business strategy worked well for European airlines and in economical high season the number of business travellers was high. The network operating system was the only business model used in the European air-travel market.

In Europe several national airlines showed symptoms of serious financial difficulties before the beginning of 21st Century. Sometimes losses of a government-owned airline can be much greater than shown in figures because many of them have received indirect subsidies and guarantees for loans from the governments to reduce the costs. Some have received fuel from national oil companies with low prices or even free of charge. It is also common for national airlines not to pay landing fees on domestic airports, no rent for offices or other space used in the national airports. When governments support the companies financially they also sometimes want to affect the management by imposing obligations for the airline, causing over-political situation that delays innovation and change. The lack of management activity can lead to the company not having a clear development strategy. Another symptom of the problems is that several national airlines are still overstaffed and employees form powerful unions. The organisational culture and bureaucracy do not support

116 Sull, 1999, European Management Journal
117 Franke 2004
customer-oriented views of service. In addition many traditional airlines have an ageing fleet of too many different aircraft types.\footnote{Doganis 2001, p 188-193}

In 1983 Colin Marshall was appointed the chief executive of British Airways (BA) and started a chain of actions that changed the organisational culture of the company dramatically. Marshall ended the military like internal hierarchy within the company and insisted on employees to call him by his name instead of his title, formed cross-functional teams and turned the focus on the customers. BA had a large research conducted among their customers and found that the crucial issues to customer satisfaction were not products and schedules, but how the customers felt in the environment of the service situations. Customers could feel the company culture and attitudes by customer service that was effective but cold, bureaucratic and lacked emotions. BA noticed that the company culture affects not only the internal functions of the company but also everyone in contact with the company. This became the important centre idea of organisational re-engineering. All staff from the grass root to management was important to delivering customer value.\footnote{Hampden-Turner 1990, p 58-60} In this successful turn-around the company changed it’s view from strictly operational bureaucracy to customer- oriented service company and service (especially targeting business travels) became their competitive advantage.

There have been several critical time periods for European airlines when they have been forced to cut the operating costs, in the beginning of the 1990’s especially state-owned airlines faced hard competition pressures and many nations restructured their national airlines by reducing labour costs and improving labour productivity. This was seen as aiming at privatising the state-owned airlines. The pressures for cutting
labour costs became acute again in late 1990’s when new entrants and low cost airlines made an impact on the markets.\textsuperscript{120}

The present CEO of Lufthansa, Jurgen Weber, stated in the Times on February 1997 that: \textit{“If we do not want to make losses again, we have to do something about our personnel costs. Otherwise I can calculate right now when we go bust, at what ticket price”}.

Source: Douganis 2001, page 101

There are several factors that affect the costs of an airline some of which are external, out of control of the airline itself. The level of airport charges or aircraft fuel is examples of external costs, while the type and size of aircraft used is an internally controlled cost. The labour costs form 20-35 per cent of the operating cost for the European airlines.\textsuperscript{121}

To cut the costs of labour, European airlines adopted several strategies, the most obvious one being cutting the number of employees. Many airlines announced cuts on staff in the early 1990’s, British Airways laid off 12\% of the total number of staff during the year 1991, while some of the state-owned airlines experienced even more radical cut offs. Hiring part time employees for peak hours and re-negotiating terms of employment became widely used strategies. Some airlines started low cost subsidiaries or formed franchising agreements with smaller independent airlines. In all possible areas outsourcing and contracting out activities previously conducted by airline own staff created savings in labour cost but also created bargaining power to buying services from others. Services commonly outsourced in airlines are in-flight catering, aircraft cleaning, passenger handling, aircraft maintenance, revenue accounting and informatics. Some of the activities that needed to be kept within the company could be transferred to countries where labour costs are lower. An

\textsuperscript{120} Doganis 2001, p 112-113
\textsuperscript{121} Doganis 2001, p 113-114
example of this is the BA software development, which is done largely in India.\textsuperscript{122}

\textit{Low-cost Airlines Enter the Market}

When the airline business was liberated in the European Union in 1997, Ryanair and easyJet became the pioneers for low-cost operations in Europe. They adapted the same system that already was used in the American market by such budget airlines as Southwest and ValuJet.\textsuperscript{123}

A good example of the low-cost strategy is the airline that has been the most successful in Europe. The business concept and strategy of the company is therefore presented in the following. Ryanair was created in 1985 and has been expanding ever since. The competitive advantage they use is the pricing policy, low price with minimum service but nothing extra. The company itself states that cost management is the secret to their success. Ryanair operates to and from airports that charge less landing fees than the main airports of large cities. There is no free service in the flight, all food and drinks are for sale. Advertising is targeted in campaigns using controversial ideas that sometimes get also negative publicity. On the website the company sometimes offers even free flights “when they feel generous”. In the last ten years Ryanair increased the annual traffic of the company from under 700,000 to over 15 million passengers. Today they predict to become the largest Airline in Europe within the next eight years.\textsuperscript{124}

The only distribution channel that Ryanair uses is the Internet page. All flights are booked through the Internet and reservations cannot be cancelled. For changing the flight details or the person using the ticket, a fee is charged. There are no pre-assigned seats on the flights but customers

\textsuperscript{122} Doganis 2001, p 116-119
\textsuperscript{123} Economist 2004
\textsuperscript{124} Ryanair homepage
select their seat on board. The airline announces in the website that this is a point to point carrier, meaning that booking of flight connections are not recommended and the company takes no responsibility in any failure to arrive in time for the connection flights. Luggage is checked to one destination only and the customer is responsible in checking the luggage on the next flight, if he/she wishes to continue to another destination. In this way the airline has been able to cut the number of service personnel needed. For guidance in booking there is only a service call centre (located in Ireland) where a customer can call in case of questions or problems. In the airport check-in desks open two hours prior to the flight (for many traditional airlines check-in is possible to do even as early as the previous day) and closes strictly 40 minutes before departure.

To ensure the low fares, the European low-cost airlines offer high frequency, short turnarounds, scheduled point-to-point short-haul flights. They operate usually with one type of aircraft with high-density seating. For the possibility of high frequency and short turnarounds they must use secondary airports and attempt highest possible punctuality. In this way they achieve sustainable cost advantage over the competitors.\textsuperscript{125}

The cost structure does not explain the entire success story of low-cost airlines in Europe. The economic downturn in year 2000 created the first signs of crisis, followed by the terrorist attack in New York that caused another downturn in air-travel, the year 2003 brought a war in Iraq together with SARS health risk and the network airlines had few new business innovations to offer besides increasing the network coverage. In the crisis and economic downturn the low-cost airlines offered an alternative for price-sensitive customers.\textsuperscript{126}

\textsuperscript{125} Doganis 2001, p 142
\textsuperscript{126} Franke 2004
The traditional airlines were forced to re-think their strategies in pricing, marketing and cost management by the low-cost airlines. Many of them chose to cut costs in order to survive the decline in passenger volume. Many companies started online ticket services, online check-in and other services that do not demand service staff. At the same time the number of staff members has been declining in the past years.\textsuperscript{127} British Airways was the first one of the traditional airlines to set up its own low-cost subsidiary, Go, in 1998 and KLM followed with Buzz in 2000.\textsuperscript{128}

There are significant differences between the European low-cost flight operations and the similar operation in the US market. First of all the low-cost carriers in the US have been domestic, while in the European market most operations are international. For example on the route London-Paris the flights compete with speed rail services. Second point is that the charter and non-scheduled services offering low fares play a much more important role in the European market than in the US. The revolution that low-cost airlines brought to the European market included not only the low price but also that flights were available for one-way travelling without any restrictions on minimum of days between the flights etc.\textsuperscript{129}

\textit{European Market Situation}

The European market is in a critical phase. Many new small airlines have started but it is expected that most of them will disappear just as rapidly as they appeared, following the development of US markets earlier. The new companies are a reason for the over-capacity in the passenger services, but not the price war in Europe. Intense competition is not only threatening the doomed newcomers but industry leaders also.\textsuperscript{130}

\begin{itemize}
  \item \textsuperscript{127} British Airways homepage, Finnair homepage
  \item \textsuperscript{128} Doganis 2001, p 136
  \item \textsuperscript{129} Doganis 2001, p 137-138
  \item \textsuperscript{130} Economist 2004
\end{itemize}
In 2004 there are around 50 low-cost airlines, number is changing week by week as new companies are launched and other drawn from the market. The success of the first low-cost airlines has encouraged others to get into the business, there have been second-hand airplanes available and the interest rates have been generally on a low level. A new factor in the competition is expansion of the European Union with ten more central- and east-European countries. So far the market leaders in European market have shown very little interest in the new countries. That gives possibilities to smaller companies as well as the local companies of these new member countries that have also entered the deregulated common market. It is also interesting that so far the low-cost operations have been concentrated in the United Kingdom.

Oum and Gudmundson state in their analysis of European airline networks that alliances are crucial in today’s airline industry because they create more value than each company could achieve on its own but without the problematic aspects of corporate mergers. They work towards a common goal. Networks are not the same as alliances but alliances can offer network benefit as alliances can cooperate with each other for destination coverage without formal tight network connection. Closeness of the network companies and the network’s position in the overall market determine the performance level of a network, this applies to the airline alliances as well. Alliances seem to be growing their strengths, yet still most airlines in the world choose forming networks instead of multilateral agreements of alliances. This is an interesting area of study that Oum and Gudmundsson recommend to the researchers of network strategy in the future.

131 Economist 2004
132 Doganis 2001, p 136
4.1.2 Alliance Strategies

Alliances are a common way of strategic cooperation in the airline industry and their development can be seen as airline companies’ response to change in the industry environment. Airline companies create both horizontal alliances between other airline companies as well as vertical alliances that are agreements between an airline company and an airport. This thesis looks only at the horizontal alliances between three or more airline companies that have formed contractual agreements.

The common forms of agreements between two or more airlines can be divided into commercial ones and strategic ones. A strategic alliance forms a joint set of business objectives and combines assets to achieve these objectives. In this form of alliance the commitment is important and shared assets can include terminal facilities, aircraft, staff, maintenance, traffic rights or capital. A shared brand and/or uniform service standard between airlines indicate that they have formed a strategic alliance. Many franchising agreements are strategic since they form a joint objective for the partners and the ultimate form of strategic alliance are full mergers of two airlines. On the other side code-share and joint frequent flyer programmes are not strategic but essentially commercial marketing alliances. Shared purchasing and ownership of part of each other’s shares does not mean the airlines in question would have same objectives; it does not lead to strategic agreement.

Strategic alliances in the airline industry represent three major types: equity/non-equity investments, franchise agreements and contractual partnerships. This thesis concentrates on the contractual ones that may or may not include equity investment. Which contractual alliance to join is

133 Oum & Gudmundsson 2004
134 Albers, Koch & Ruff 2004
135 Doganis 2001, p 65
determined by customer demands, market areas of interest and growth, as well as regulatory and competitive factors.  

Apart from trying to achieve the economies of scale, the airline companies join alliances in hope of increasing marketing power that will result to increase in sales and financial results. The most important marketing benefit is the “code-sharing” that offers the customer the possibility to plan flight connections. This is because the code-share flights have the code /flight number of both companies involved which means that these flights will be easy to find when booking flights through computer systems, either online or through ticket sales. Both parties involved will sell tickets to the same flight, operated by one plane, one airline. This form of cooperation was created in the 1980’s before forming multilateral alliances.  

Regional alliances among airlines are usually commercial agreements covering several routes to and from a specific country / region or franchising between a larger carrier and smaller “feeder operators” offering connections to the flights of the larger airline. Most significant form of airline alliances is the global alliance. The main purpose for creating global alliances is achieving all marketing benefits or scope and cost economies through synergy. Airlines operating in geographically distant markets, possibly even in different continents form an alliance that includes not only code-sharing but also schedule co-ordination, joint sales forces, frequent flyer programmes, ground handling services, maintenance and so on, in some cases even mutual equity stakes.  

Forming multilateral alliances can be seen as a strength and development for a company but also as a sign of industry changes that

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136 Mockler 1997  
137 Shaw 1999, p 89  
138 Doganis 2001, p 67-68
creates threat to companies. Joining an alliance can be a form of coping and surviving. Michael Porter (1990) has stated that alliances respond to threat and industry uncertainty and only necessary for a certain period of time in a difficult business situation. In airline business the agreements such as mergers, joint ventures and alliances have a long history. The large European airlines started with acquisitions, franchising and other agreements in order to create a dominant status on their national markets before expanding the efforts to other countries. Many larger airlines chose to take over smaller airlines already operating on the new markets and to re-create their brand. Lufthansa, SAS, KLM and Swissair followed pretty similar strategies through the 1980’s but British Airways formulated a clear strategy based on three key issues: to dominate the national home market (the United Kingdom in the case of BA), be present in other major European market areas (Germany and France) and to create a global network coverage through alliances with American and Asian/Pacific carriers (most importantly American Airlines). The alliance coverage strategy of BA was imitated later by many other European airlines. According to the company itself, British Airway’s goals of being among the most powerful players in the industry cannot be achieved without alliance strategy.

In the 1990’s joining the international alliance network became reality to many of the world’s airlines. Two international alliances still alive today are the Star Alliance and oneworld Alliance. Many rival alliances have already fallen but also one (SkyTeam) has more recently been created.
The member airlines in Star and one world alliances in 2004 include:

**Star Alliance**
- Air Canada
- Air New Zealand
- ANA
- Asiana Airlines
- Austrian
- Blue1
- BMI
- LOT Polish Airlines
- Lufthansa
- SAS
- Singapore Airlines
- Spanair
- Thai Airways International
- United
- US Airways
- VARIG

**oneworld Alliance**
- Aer Lingus
- American Airlines
- British Airways
- Cathay Pacific
- Finnair
- Iberia
- LAN
- Quantas

Star Alliance grew from the code-share operations, shared marketing activities and destination planning between Air Canada and United Airlines, Lufthansa, SAS and Thai Airways International. In May 1997 these five airline companies launched the Star Alliance. Today they market flexible round the world fares with access to 772 airports in 133
countries.\textsuperscript{144} The \textbf{oneworld} alliance has flights to 571 destinations in 135 countries.\textsuperscript{145}

In the past years the Dutch airline KLM joined a network with Alitalia, Northwest and Continental. In May 2004 a new Air France – KLM Group was formed by merger of the two Middle-European airlines Air France and KLM. Together the companies now form the largest European airline and hope to achieve synergy benefits and competitive advantage operating from both Amsterdam and Paris. Both airlines have had different routes and from 2004 combine them to a flight network that covers Europe largely.\textsuperscript{146}

Today the Air France – KLM Group is part of the SkyTeam Alliance, founded by Air France and Delta Air Lines in 1999. The alliance has 658 destinations in 137 countries. The member airlines of \textit{SkyTeam} in November 2004 include:

\begin{itemize}
  \item Aeromexico
  \item Alitalia
  \item CSA Czech Airlines
  \item Korean Air
  \item Air France – KLM, Continental Airlines, Delta, Northwest \textsuperscript{147}
\end{itemize}

The Qualiflyer alliance started by Swissair in 1992 survived until 2002 when the member companies decided to dissolve the alliance network and terminate the frequent flyer scheme. The airlines that left this alliance were: Swissair, Crossair, Air Europe, LOT Polish Airlines, PGA

\textsuperscript{144} Star Alliance homepage  
\textsuperscript{145} Oneworld Alliance homepage  
\textsuperscript{146} Air France homepage  
\textsuperscript{147} Skyteam homepage
Portugal Airlines, Sabena, Air Liberte, Air Littoral, TAP Air Portugal and Turkish Airlines.\textsuperscript{148}

According to Shaw (1990) the airlines have two major reasons for joining an alliance: they seek cost advantages by increased access to economies of scale and marketing benefits by economies of scope. Alliance cooperation increases the bargaining power especially towards the aircraft and engine manufacturers, fleet planning and orders can be done jointly, ground handling can be agreed in the way that airline personnel serve all the flights from their home destination while others take care of other airports, sales teams can be joined and computer systems integrated. There are risks involved in these processes, since the airlines have to trust the capacity and level of service that the others can offer. The success or failure of the alliance does not depend on a single or a few companies but will certainly affect all of them, which means giving part of decision-making power outside the company.\textsuperscript{149}

Airline alliances are very international serving customer from all over the world. They need to constantly monitor situations in the countries they operate in as well as the global market. New alliances can be formed, new competition will arise and some will go out of business. Choices need to be made concerning the area the companies target and operate in, competitors need to be constantly followed, costs and risks evaluated (a large part of costs in the airline business consists of the oil prices). Environmental and political situations are much more important in global than local businesses. It is also more difficult to monitor customer needs and react to changes when the target market is diverse.\textsuperscript{150}

\textsuperscript{148} Qualiflyer homepage
\textsuperscript{149} Shaw 1999, p 89
\textsuperscript{150} Houlden 1996, p 139
4.1.3. Cost Leadership and Differentiation in Airline Business

Airline business illustrates clearly the cost leadership strategy in creating competitive advantage. The success of the US-based Southwest Airlines in low cost operation turned the attention to low-cost strategy in the airline business. Southwest has been profitable since it was founded in 1973 but attracted most attention to its strategy in the beginning of 1990’s. The airline made business decisions to operate on lowest possible operating costs and to sacrifice as many service features as customers would accept.\footnote{Shaw 1999, p 83-84}

Concentration on one aircraft type brings savings in pilot training as well as aircraft service maintenance and spare parts. High level of asset utilisation, short turnarounds and use of secondary airports support each other and form a heart of low-cost airline strategy. When operating costs are as low as possible, the next issue of concentration are the costs of distribution. Technology development and Internet offers possibilities in cost savings for ticket sales, agency commissions and marketing. Sacrifices need to be made in passenger services and clearly safety is the number one issue that customers cannot compromise. After safety issues low-cost airlines have to put efforts in punctuality to achieve short turnarounds but also for customer value. Low-cost airlines do not transport luggage at the airports but customers have to carry luggage themselves to check in for another flight, if they wish to continue their travel. The concept of cost leadership is blooming in airline business and deregulation offers airlines opportunities in new markets.\footnote{Shaw 1999, p 83-84}

Figure 7 compares the low-cost airlines’ operations to the traditional network airlines’ cost structure to identify in which areas they create the main differences.
Even with growing interest in cost management in the airline industry, there are companies that clearly differentiate themselves from competitors. In European market the large players British Airways, KLM and Lufthansa fit into this strategic concept. They offer wide range of products from first class luxury to standard economy class tickets aiming at covering all market segments and using their networks to cover all areas.\textsuperscript{153}

This strategy offers advantages and synergy benefits but also involves risks. They operate on high cost structure and wide range of products makes strategic decisions more complex. When investing on service, comfort and mixed fleet, these airlines need to get full use of synergy benefits of large network to share the risk. Wide networks can offer customers more flight connections and also more attractive frequent flyer programmes. As a general rule larger network creates better chance

\textsuperscript{152} Shaw 1999, p 83-86
\textsuperscript{153} Shaw 1999, p 86-87
for success in this strategy. Networks, namely strategic alliances, are crucially important for airlines in differentiation strategy.\textsuperscript{154}

4.1.4. Airline Customer Needs

Customers in airline travel must be analysed in the way who are the people travelling, what means of transportation they will choose, what class or service level do they expect and which airline they are likely to travel with. On short routes railways or buss services can often offer shorter times for the journey to stations located closer to the customer’s home than the airlines. Today customers can choose between many different travel classes and service standards.\textsuperscript{155}

The most tangible form of competitive advantage is the customer’s perception on was the product/service reliable and effective. The basic service performance is still the core issue in many industries but the challenge is to keep the basics functional while also performing better in HOW to deliver the basic service.\textsuperscript{156} Convenience, easy to use services and speed have grown in importance. Speed of service can mean both getting in contact with the customers quickly and responding to their needs but also helping customers to save time. In airline business this mean flying closer to main cities and having effective transportation to and from the airport. Also ticket sales and online services saves customers’ time. Convenience can create competitive advantage meaning product/services that are easier for the customer to use. Also this can enhance the easier lifestyle or business convenience. With addition to basic service these

\textsuperscript{154} Shaw 1999, p 87-88  
\textsuperscript{155} Shaw 1999, p 9  
\textsuperscript{156} Kare-Silver 1997, p 117
performance issues can help to create competitive advantage over competitors.\textsuperscript{157}

Customer satisfaction can be achieved by offering a service standard that at least meets the customers’ expectations or in the best case exceeds them. The needs of an airline customer can somewhat differ from needs of customers of other types of services. Just knowing what the different customer groups need is not enough, airlines need also to prioritise which needs they wish to fulfil.\textsuperscript{158}

For a business passenger frequency and the timing are essential qualities of short-haul flights within Europe. They are busy and they need to be able to change their plans on a short notice. This is why they would be likely to choose to travel with an airline that can offer flights to the significant destinations frequently. Punctuality, airport location and accessibility is important for a business traveller for the same reason, any delay means inconvenience. Seat availability and ticket flexibility are values that make it possible for a customer to change their flight ticket even shortly before the flight departure. The frequent flyer bonus forms an extra opportunity for a business passenger who travels a lot but especially on short flights the bonus miles are not enough to make them change their choice to less convenient flight arrangements for collecting the bonus. Business travellers tend to appreciate service at the airports and in-flight, everything needs to be taken care of in a fast and effective manner at the airport. Luggage service is important in affecting the travel time and lounges can offer the business traveller the place and facilities to make last minute arrangements and business calls.\textsuperscript{159}

\textsuperscript{157} Kare-Silver 1997, p 135-139  
\textsuperscript{158} Shaw 1999, p 26-27  
\textsuperscript{159} Shaw 1999, p 27-30
The leisure traveller has somewhat different expectations than the business traveller. Unlike in the business segment, customers are spending their own money. This customer group has grown more heterogeneous through the years and it consists of both women and men unlike the male dominated business travel segment. The dominant customer expectation in this group is obviously a suitable price; this becomes significant when customers travel in a family group and pays the fare multiple times. Families tend to focus their travel budget to the destination, a good standard hotel and meals. The leisure traveller tends to plan the travel in advance, this means that the airline does not need available seats in the last minute but can book an aircraft knowing how many passengers will travel.\textsuperscript{160}

Timing needs of a leisure traveller are different from the business traveller; the demand is seasonal. Leisure flights can depart during the early or very late hours of the day, leaving aircraft free during the regular daytime flights. Some features and services can be cut to offer cheaper fares; many airlines use more seats in the aircraft for leisure flights and offer no free meals or drinks. Safety and punctuality are the most important expectations also in this group of travellers and cannot be compromised.\textsuperscript{161}

4.1.5 Conclusions

The European market is in a critical phase, following the same development as the US market years before. Many new small airlines start in the market but most of them will disappear just as rapidly as they appeared. There is an intense price war in parts of the European market. Traditional airlines have chosen different strategies to survive; many have

\textsuperscript{160} Shaw 1999, p 27-30
formed worldwide network connections and joined alliances. Multilateral strategic alliances offer airlines the possibility for economies of scale, international route connections and joined frequent flyer benefit for the customers, also creating stronger market position for the company together with cost savings. In the European Market several multilateral alliances have been formed since the 1990’s and today three are alive: SkyTeam, Star alliance and oneworld alliance.

After deregulation of the air-travel market, several low-cost airlines have started. The most successful so far (and among the first ones to start) have been Ryanair and easyJet. Their cost structure and value chains differ from the traditional airlines. Air-travel customers can be divided roughly into two main groups, business travellers and leisure travellers but knowing what these customer groups need is not enough, airlines need also to subdivide the customers into smaller segments and define which groups to target. British Airways is an example of a company that clearly has taken customer service as their competitive advantage. The company analyses customer data carefully in order to know their customers and being able to offer them superior service. The company has also started its own low-cost subsidiary. Some other large airlines have followed their decisions.

4.2. Personal Interviews

4.2.1. Findings, oneworld Alliance [Finnair]

The first question asked the respondents their perception of what does good passenger service mean in airline business today. According to the Finnair respondent, in short good passenger service means that a passenger and his/her bag are traveling on the flight s/he has booked. In

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16 Shaw 1999, p 36-37
addition to the core service there are other services creating customer value, such as lounges, frequent flyer programme (Finnair Plus), brand and the environment.

For a question if alliances increase the level of service quality he answered: “In the oneworld alliance there are certain delivery requirements that every member has to fulfill. Usually the implementation time is 6-12 months prior to joining the alliance. We also have what is called the best practice where the policies and procedures of the airlines are compared. If an airline feels there is something to be improved and the model of another member carrier is suitable they will adapt accordingly.” If the service quality is already on a certain level the alliance does not change much in the quality. For a small airline the alliance offers access to several destinations and possibilities of connection flights. The oneworld alliance standards cover all areas from airline management systems, security and service standards all the way to the measurements of space for one seat onboard or ticket procedure. Therefore there should not be huge differences in customer service between member airlines and all the member airlines should treat any oneworld customer as their own.

Main benefits of alliance membership for a single airline are:

1. Increased customer proposition (connections, lounges, service)
2. Increased sales (code-share, connections, shared sales efforts)
3. Decreased costs (joint procurement)
4. Help in competition (more destinations)

If possible, outsourcing is done in cooperation with another member airline. For a small airline joint procurement offers good advantages. For Finnair the location in northern Europe can offer challenges.

The most important positive and negative effects the low-cost airlines have had on the European market:
Attracted passengers to airlines that would have traditionally used other means of transportation or not traveled at all.

Made traditional airlines think about their business model.

Created distorted price image in peoples’ minds.

Taken away passengers from traditional full-service airlines.

The respondent was also asked if traditional airlines move closer to the low-cost airlines strategy. The strategy of traditional airlines is still to offer full-service, to the main airports and offer transfer possibilities. However, in certain routes, traditional airlines have moved closer to the low-cost airlines in moving into one class model and paid meal and beverage services. This comes from the fact that in those routes where low-cost airlines are operating without service and low prices, the traditional airlines have been forced to do the same, as full-service concept cannot be fulfilled with the prices of low-cost airlines.

A clear example of this is Aer Lingus in oneworld alliance. The Irish national airline has been forced to change its value chain and operations systems especially in the routes between the cities of Ireland and UK because of the pressure Ryanair has forced on to them. In transatlantic operations the company still offers full-service concept with higher fares. Aer Lingus seems to have succeeded in this since after many difficult years, the company makes profit again. Many other airlines have chosen to strengthen their strategy as full-service airlines. British Airways is one of them. Also Finnair stays strongly with the full-service and alliance strategies.

Self-service and online experiences for Finnair have been good. As the passenger volumes increase and the peak times cause long waiting times at airports so it is crucial to find alternatives how to process passengers before they arrive to the airport.
The respondent believes in the future of alliances. “The alliances are constantly growing and I do not see any reason why they should not do that also in the future.” All alliances are concentrating on developing the customer experience with main aspects in global support, ease of transfer, assurance that service from all airlines is top quality, recognition of frequent flyer points, lounge access and other oneworld frequent flyer benefits.

The last interview question was predicting the situation in Europe after 8 years, how many airlines will survive? Bankruptcies and merges seem inevitable. Eight years is a long time to predict in the airline business, very much has happened during the last 8 years. Only few airlines surviving in Europe seems an exaggerated prediction to the respondent and for the future of Finnair he predicts: “Finnair will be a part of an alliance, we will be a full service airline and we will succeed”.

4.2.2. Findings, Star Alliance [SAS Group]

The SAS Group representative was asked the same set of questions than the Finnair representative in the previous interview. The first question asked the respondent’s perception of what does good passenger service mean in airline business today. According to the SAS Group respondent, good passenger service means first of all decreasing the time from departure place till destination point. Also it refers to non-delayed luggage delivery, so that passengers are not worried about it, and they do not have to take care of luggage themselves. This affects passengers’ thoughts about the particular airline and increases their willingness to use that airline’s service also in the future.

For the alliance’s effect in an airline company’s service, the respondent stated that it absolutely affects the level of service. The reason
why is that the main purpose of the alliances is to establish a global network. Global network covers various services, such as route coordinating, harmonizing the standards, and transferring luggage. The main benefits of alliance membership that the respondent mentioned, especially in the case of SAS Group’s membership in Star alliance are:

1. Global route network. This mostly helps in the “From departure until destination flight with the least possible delays” criteria. For example, before alliance membership SAS group offered its clients routes to a little more than 30 countries and 130 airports, now with the assistance of Star members the group offers passenger routes to 82 countries with approximately 700 airports. These offerings make SAS group compatible with other airlines.

2. Obtaining passengers. In case passengers requested a route from one of the members of Star alliance, and they are not able provide it, these passengers are redirected to other members of alliance. In this way, all members coordinate together, and try to keep the passengers for the member airlines, rather than letting them go to other non-member airlines.

3. Joint IT and service developments, shared costs. Thinking the Star’s establishment purpose, it mainly relies on joint product and IT developments. So, the successful implementation of new service or IT development, are recommended to other members in order to increase the efficiency and decrease the human labour. Also there is a specific team in the Star alliance working on the product and IT developments and possibly establishment of a unique brand.

One of positive effects the low-cost airlines have had on the European market is that low fares attracted a lot of new passengers, which were not using airline service as a travel mean. Another benefit is that those customers, who want to fly urgently, may not find a flight in desired time
with Ryanair or other low-fare airlines. Low-fare airlines offer more expensive fares than classical airlines in urgent situations. The most important negative impact of low-fare airlines on the market is that they have taken many average-income passengers, which before used the traditional airlines’ services. By emergence of low-fare airlines, a very competitive market situation evolved. Another negative impact on the market is that they changed the public opinion about fares. People became aware of low-fare tickets (although the service is not equal), and some of them certainly will abandon fares with traditional cost.

The respondent feels that both low-cost airlines and traditional full-service airlines are moving strategically closer to each other. In case of traditional airlines they are opening special units with low fare flights or start to offer random low-fares in all routes. On the other hand, low fare airlines also moving towards traditional airlines. This is an unavoidable process, since low-fare airlines are expanding their route networks and their maintenance costs are increasing, their fares will also become more expensive. So there will be a golden medium level, which first movers to that point will succeed at and get better market position.

When asked if the online and self-service experiences will be a growing part of airline service, the respondent answered that in some cases they are, in Star alliance mainly self-check-in and online-booking. Intercontinentally they work with sales agents because they are more familiar with local customers, because they have enough freedom for selling and they also try to increase their benefits by selling more.

In the question are the alliances developing closer cooperation, the respondent answered: “Possibly yes”. An alliance is working on issues such as common handling and common maintenance, common fuel providing and similar trends. However, there is no expectation of merger
between member airlines of Star alliance. “At least it is not the purpose of alliance”, he stated.

The alliance strategy of SAS Group will focus mainly on the so-called network strategy, attempting to attract new members and expanding the route network. Also product - brand strategy will be directed by the alliance strategy of the group.

Predicting the future, especially the next eight years in the industry, the respondent states that: “Nowadays, there is a recession in the airline business, especially in the European market. However we believe that this is a phase of a business cycle, and it will be replaced by more beneficial situation for airlines. On the other hand, the airline companies have too much capacity for current European market. Therefore, it leads to additional costs for them. We can say that there will be several bankruptcies or possibly consolidations. The SAS Group’s situation is hopeful. It is the 4th largest airline group in Europe, and has a profitable home market. The fares in some routes are now almost equal to those of low-cost airlines. We cut off our costs mainly by alliance membership, implementing technical developments. And we think that in the near future, low-cost airlines also will begin to offer some services, in order to attract business people, and it will increase their costs, consequently the ticket prices. Also, the European market is expected to grow in the near future, thus recession period will end. Therefore, considering the group’s strength and strategy, SAS will be one of major players in European airline market in near future.”
4.3 Strategy in Practise

This chapter will view secondary data to find out strategic decisions and directions in business, which the Finnair Group and SAS Group as a whole have chosen as their priorities during the past few years. In order to understand strategic decisions, the organisational structure of the groups will be shortly presented, followed by data gathered from media sources and annual reports of both companies. Most attention is paid in the customer service concept on scheduled flights and cost management.

4.3.1. Finnair Strategic Decisions

The national airline of Finland is mainly governmental-owned. The company has a long history dating back to 1923. The goal of the company is to be number one in Nordic skies; its competition strategy is based on high level of service, punctuality of flights and wide cooperation network. To find competitive advantage in the future Finnair identifies and uses constantly new distribution channels and develops its service concept.\(^{162}\)

In the Scandinavian market Finnair entered the budget airline market in 2003 with a majority of shares in the Swedish low-cost airline Nordic Airlink, which today operates under the name Fly Nordic. The low-cost airline is one step in the Group's growth strategy.\(^{163}\)

Figure 8 presents the organisation structure of Finnair Group.

\(^{162}\) Group Info, Finnair homepage  
\(^{163}\) Finnair Annual Report 2003, Fly Nordic homepage
This thesis concentrates on general group strategy and the scheduled passenger services in the European area. Scheduled Passenger Traffic is the Group's largest division and forms 80 per cent of the external turnover. The service of scheduled passenger traffic includes passengers and freight customers. Partners inside and outside the oneworld alliance create a worldwide network for air transport customers, as the scheduled passenger traffic business today requires networking on many levels. When the operating environment has become more and more challenging, Finnair concentrates on operational and service quality but at the same time the financial situation needs to be kept healthy.  

**Cost Cutting and Ticket Prices**

The world economy has recovered slower than expected, which affected the customers' increasing price consciousness. The traditional airlines have been forced to react to the competition by renewing their pricing structures, intensifying the competition. Finnair implemented a large reform of domestic and European tickets in autumn 2003 when the rules-based pricing was changed to flight-specific pricing. This enables
customers to buy different classes for outbound and inbound flights. The flexibility of routing was also improved. Finnair sees that the new pricing principles have a positive impact on both price image and demand. Ticket sales via the Internet nearly doubled in 2003 compared with the previous year. Internet bookings then formed just under ten per cent of all tickets sold. The price reform caused a sharp increase in Internet bookings towards the end of year 2003.\textsuperscript{165}

Most of Finnair's Eastern Europe flights started to operate with only one travel class while other routes still serve also business class. Finnair also made a decision of not paying the travel agency sales commissions. The change in flight pricing and service concept aims at cost savings but declining revenues has also forced the airline to cut production costs. The service personnel structure has been changed to volume-based. The cost cutting has aimed at minimum impact on passenger comfort and customer feedback has been followed through the process.

Organisational processes have been rationalised to increase profitability and to cut costs. In this development the key objectives are improving operational quality, service fluency and cost-efficiency. Finnair is a leading airline in the utilization of e-business and wants to sustain its position in the digital technology development. The new applications speed up the passenger service and make organisation’s internal processes more effective. A programme for procurement activities is the next one to be developed and at the moment the programme is one of Finnair Group's strategic priorities. Already number of subcontractors in procurement has been reduced and supply agreements have been centralised.
Business Strategies

In the latest interview available on the company’s homepage, Finnair CEO Keijo Suila states that the market share of Finnair is strong and growth is expected in the Asian routes, East-Europe and namely from the Baltic countries as well as Russia, but also from the Scandinavian market in the form of the Fly Nordic. The re-structuring of flight fares in 2003 has created volume and taken down the price level but the prices have already reached the end of the decline and are expected to slowly rise again. The company will report losses at the end of the year 2004 but from the following year a profit can be expected.\footnote{Suila 2004, Interview}

Also presented in the company’s homepage, the strategic manager of Finnair states in an interview at the end of 2003 that Finnair wants to hold on to the level of service in security, punctuality and passenger services. The IT technology and digitalisation of both customer processes and internal processes can create profitability and competitiveness in the near future. Finnair is not going to change its structure closer to the low-cost airline structure but has started Fly Nordic subsidiary based in Arlanda Stockholm, offering cheap fares in Sweden. The senior vice president, strategic planning of Finnair states that between four and five per cent of all customers use the online ticket booking service and online check-in at present but the percentage will grow in the future as customers get used to the online services.\footnote{Suila 2004, Interview}

4.3.2. SAS Group Strategic Decisions

SAS group was founded in 1951 after formation of alliance between ABA (a Swedish company), DDL (a Danish company) and DNL (a Norwegian company) after long negotiations, which were interrupted by
world war. After this year, the group has constantly expanded its route network, increased and improved its fleet, and offered more services to passengers.

The business concept of SAS group is to serve air travel needs in Northern Europe. The overall business of the Group is developing several airlines and supporting activities that have a great potential to become profitable market leaders in selected market segments. In order to implement this strategy, main objectives are identified every for every five-year period. For the period of 2000-2005 there are four common objectives in front of Group:

1. To achieve an average Cash Flow Return On Investment of at least 20%  
2. To strengthen the Group’s market position in the Northern European airline market  
3. For each unit to achieve customer satisfaction, employee satisfaction and environmental targets  
4. For airline operations to achieve their flight safety targets.

Focusing on Northern Europe market, SAS group considers Scandinavian market as home and most profitable market. SAS group has three international hubs, which are in Copenhagen, Oslo and Stockholm, and they serve for routes to southern and eastern Europe and intercontinental routes.
The SAS Group functional business structure is presented in the following figure:

*Figure 9: SAS Group Organisation*

*Source: http://www.scandinavian.net Structure of Group*

As can be seen from above figure, SAS group includes Scandinavian Airlines as a parent company, and there are other airlines, which either operate as subsidiaries (Spanair, Braathens, Blue1 and Widerae’s Flyveselskap) or affiliated units (airBaltic and Estonian Air). Other units in the structure are related to the airline travel.

The SAS group was one of the founders of Star alliance in May 14, 1997, the first truly global airline alliance offering its customers convenient global access, a seamless travel experience, and worldwide status and
privileges.\textsuperscript{171} From that time, SAS Group has been operating in cooperation with other member airlines and considers these relationships in its strategic decision-making process. SAS Group mainly offers its routes in cooperation with Lufthansa (to Asia and Africa), with United Airlines to North America and with Varig (to South America).\textsuperscript{172} In 2004, regional carriers such as Spanair and Blue1, which are separate units of SAS Group, were accepted as members in the Star Alliance. It was SAS Group’s success that both airlines met the alliance requirements.

During the past decade, the SAS Group achieves results that are sustainable economically, but also environmentally and socially. The Group’s employees are one of its leading competitive advantages, and in their day-to-day work they create long-term relationships with customers, thus strengthening the company’s brand. After the deregulation of European air-travel market in April 1997, the business environment became very competitive for SAS Group also. The low-cost carriers got the opportunity to enter the focus market of SAS Group without any barriers. Therefore, the Group had to rethink its strategy to keep the positive business results that were achieved during the 1980s and mid 1990s.

\textit{Rethinking the Strategy and the Cost-Reduction Programme}

After facing challenges in the market, SAS Group decided to reduce company’s operation costs. Wars in Afghanistan and Iraq, very high fuel prices and SARS decease had affected adversely the market in early 21\textsuperscript{st} century, making it very tough for all traditional airlines, as well as for SAS Group. Especially the year 2003 was disastrous; first quarter was remembered primarily due to the war in Iraq and economic uncertainty. The beginning of the second quarter was dominated by SARS decease,
which hit air traffic to Asia very hard, while economic weakness continued. Therefore, in the beginning of year 2003, the management board of SAS adopted a Turnaround 2005 programme. The target was to achieve cost reduction amounting to approximately 14 billion SEK.\textsuperscript{173}

The Turnaround 2005 programme referred to cost reductions in all Group units. It mainly aimed decrease of the number of employees and divestment of inefficient subunits. As a result it was considered to achieve increased cost efficiency and by that be able to offer tickets with lower prices. As the president and CEO of SAS Group, Jorgen Lindegaard stated: “The SAS Group’s Turnaround 2005 is creating competitiveness. A new Group structure of many airlines affords us new opportunities and a stronger platform for the future.”\textsuperscript{174}

Under the Turnaround 2005, for employee redundancies, a total of 6,000 full-time positions were identified. Of these, 2,450 full-time positions have been phased out (employees have left the SAS Group) by December 2003 (250 in Corporate Functions, 1,450 in Scandinavian Airlines, 550 in Airline Support Businesses and 200 in Subsidiary Airlines).\textsuperscript{175} The SAS Group also started collective agreement negotiations with all employee groups with the aim of ensuring salaries, benefits and pensions at market levels in relation to competitors. A large portion of the remaining approximately SEK 2 billion in Turnaround 2005 would thus be achieved. Additionally to the employee negotiations, the SAS Group announced that five office properties in Copenhagen had been sold and leased back. Also the properties at the head office in Stockholm were sold to Nordisk Renting and leased back in the end of year 2003.\textsuperscript{176}

\textsuperscript{173} SAS Group’s Annual Report 2003
\textsuperscript{174} SAS Group’s Annual Report 2003
\textsuperscript{175} SAS Group’s Annual Report 2003
\textsuperscript{176} SAS Group’s Annual Report 2003
Moreover, other changes have taken place in SAS Group’s strategy. In the beginning of 2003, the group announced the launch new special unit, called Snowflakes. 177 This was the group’s first attempt to implement the new low-fare concept. The purpose of this special unit was to offer low-fare flights in certain routes. However, in 2004 this unit was closed, and low-fare tickets were introduced in all routes in the Scandinavian market. The Group also decided to implement ReadSoft's software for electronic invoice processing, to cut down on invoice handling costs and increase invoice processing efficiency. In 2003, the SAS Group announced that parts of Revenue Accounting will be relocated to India, for the reduction of labour and residence costs.

The strategic change process in the Group continued also in 2004 but mainly through Turnaround 2005 programme. There were also other strategic decisions made in 2004, such as incorporation of SAS Ground Services and SAS Technical Services; integration of the Norwegian flight operations of Braathens and Scandinavian Airlines to a single unit in Norway; divestment of Scandinavian IT Group. These decisions illustrate the structural change process.

177 SAS Group’s Annual Report 2003
5. Analysis

The purpose of this thesis is to find out what strategic decisions the European traditional airlines have made during the recent downturn in the industry. This can be seen through how the alliance member airlines perceive the competitive situation with low-cost airlines in Europe. This part combines the findings from the personal interviews and secondary sources with the help of the theoretical framework. Both industry level strategies and company level strategies are analysed. Case companies SAS and Finnair represent the company level analysis of European full-service airlines. The analysis joins all information gathered for this study, in order to see the strategic directions that airlines are choosing in the European market. Decisions are strongly affected by alliance connections and the different alliances have taken different concentrations in search for customer value.

5.1. Industry Analysis and Value Chain Analysis

As Michael Porter suggested Industry analysis is a way of positioning the companies in relation to their competitors. Knowing the market is important background for competition. Also a value chain analysis gives background to the strategies and structure of traditional airline companies. These alone are not enough for companies to make strategic decisions but offer the basic knowledge of the industry.
5.1.1. Air-travel Industry Analysis for Europe

The structure of air-travel industry meets the characteristics of a network industry where many of the companies are linked together in many types of cooperation in bilateral (between two companies, for example code-sharing) as well as multilateral (three or more parties, for example strategic alliances) agreements. Alliances have an important effect on the industry and competition situations. Although the European market area has been liberated from the highly regulated form, there are still many significant technological, economical, social and political forces guiding the business. The industry is sensitive to incidents such as the SARS virus epidemic or terrorism and changes in customer demand.

The forces in air-travel industry and bargaining powers between partners in a present situation are analysed according to Porter’s five forces analysis in the following paragraphs one group at a time:

The Suppliers

The suppliers in airline business are mainly plane producers and fuel producers, which are very large companies in heavy competition with each other. Therefore, the bargaining power of suppliers is not very high. Although there are several smaller suppliers for example offering in-flight catering, entertainment equipment, uniforms and many other products needed. The strategic alliances increase the bargaining power of airlines when they make joint purchases. Also many airlines have outsourced parts of operations, such as cleaning and catering. This means that the airline gets to choose, witch company they will give these operations to.

The Buyers

Buyers’ bargaining power influences the prices that company can charge. In European airline industry, customers could be divided into
When Network Strategy Is Not Enough – The Case of European Full-service Airlines

two groups. Airlines usually commit themselves to the satisfying of one of these groups needs.

1. The business people, who demand comfort, on-time flight, short flight-connection breaks, in-flight service and flexible ticket conditions.

2. The ordinary European leisure traveler, who prefers to buy flights with cheap fares. They wish to travel more with the same amount of money, even with lower level of in-flight service and long waiting times at airports.

The Rivalry

In the European airline market, the rivalry is now mainly concentrated between low-cost airline companies and traditional airline coalitions (Star alliance, oneworld alliance and SkyTeam). The success of low-cost operators has encouraged new entries. Due to the attractiveness of industry, several companies emerge and go bankrupt annually. Since the air-travel is a service industry, competition focuses mainly on customers rather than resources. Competitive advantages are either high-quality driven (in case of business and diplomatic travellers) or low cost driven (in case of individual ordinary passengers).

The New Entrants

When the low-cost operators entered the market, prices were affected significantly. The success of these companies, such as Ryanair and easyJet, attract new competitors to enter the market, which is anyhow on a mature state already. There is already over-capacity in many European routes and the market cannot support all competitors, even fewer new entries. This makes the entry very difficult. The existing companies are strongly positioned and full-service airlines organised networks with membership of alliances. There are still powerful economic, political and
social forces influencing the industry, technology and equipment are expensive and the price of oil very high.

*The Substitutes*

Referring to the European airline industry, the importance of substitutes is very high. European rail and bus transportation, as well as car transportation are all substitutes for air-travel. Not travelling at all is also an increasing possibility encouraged by telephone conferences, Internet and other technological development.

Figure 10 shows the forces affecting European airline Industry according to Porter’s industry analysis model:

<table>
<thead>
<tr>
<th>Suppliers</th>
<th>Industry Competitors:</th>
<th>Buyers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel suppliers</td>
<td>Star, oneworld, SkyTeam, Ryanair, easyJet etc.</td>
<td>1. Business Travelers</td>
</tr>
<tr>
<td>Aircrafts</td>
<td></td>
<td>2. Leisure Travelers</td>
</tr>
<tr>
<td>Technology</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**New Entrants**

Airlines in other markets.
New low-cost operators.

**Substitutes**

Bus Services
Trains
Private Cars
Not traveling

Suppliers have LOW bargaining power.
Political and economic situations affect the oil price, which creates the main cost.

Buyers have HIGH bargaining power.
Social and political situations affect the buyers very much.

*The entry barrier of the industry is HIGH but number of new entrances is still also HIGH.*

*Figure 10: Five Forces in European Air-travel Industry*
5.1.2. Value Chain of an Airline

In European air-travel market, until the emergence of low-cost airlines in late 1990s, different traditional companies employed quite similar value chain structures. However, low-cost airlines, specifically Ryanair introduced new structure for airline companies’ value chain. In this case, the inherent efficiency of the different value chains determines relative cost position of companies in the market. The low-cost airlines give a brilliant example of how to achieve cost leadership by reconfiguring the value chain. While the traditional airlines provide full service to their passenger and employ much sales force, low-cost airlines abandon these costs, and therefore get a competitive advantage over classical airlines. This probably was the main reason of success of low-cost airlines in past five years.

The low-cost carriers introduced a new way of looking at the value chain and left out all possible parts of the value chain that they assumed for the customers to accept. Security and on-time flight schedules were seen as highly important to all customer groups but sales efforts, personnel costs, organisational structure and management levels as well as customer services were adjusted to low-cost level, as light as possible.

This can be seen when looking at a typical airline value chain. Figure 11 presents which primary and supporting activities an airline needs to recognise. The upper part of the figure shows the support activities: infrastructure, human resources management, technological development and procurement areas. The lower part gives examples of primary functions of airlines. There are clear differences in how these activities are performed, which separate the low-cost operations from full-service airlines and make their structure difficult to imitate.
When Network Strategy Is Not Enough – The Case of European Full-service Airlines

The infrastructure of a low-cost airline is kept as flat as possible and both human resources management and procurement are important areas to control. These companies tend to hire people in part-time work relationships so that personnel can be used at rush hours and between them in a flexible way. Luggage services and sales activities can be decreased to minimum level when not booking connection flights and selling the tickets only via Internet site. Services are cut; there are no free on-board services (such as entertainment, beverages, food or on-board internet service called the Fly Net). In the planes there is only one class, economy, or minimum amount of business seats. After sales service, customer help and complaints are handled in call-centres only.
5.2. Strategic Analysis, Finnair

In the home market, Finland, Finnair has a very strong market leader position. It dominates the domestic market with 80% of the air traffic inside the country and holds a 50% share of international flights (in and out from Finland).\textsuperscript{178} After the difficult years and losses, the CEO predicts that a growth period will begin. To increase cost efficiency, the company has gone through a significant cost cutting process and renewed half of its fleet. These, in addition to the technological development of digital processes and membership in one\textsuperscript{world} alliance, are the group’s weapons in achieving competitive advantage over its competitors.

\section*{Development in Figures}

The Following table presents figures from the latest available Annual Statement from the end of 2003, the passenger volume figure for 2004 was published in media at the end of the year.

\begin{table}[h]
\centering
\begin{tabular}{lcccc}
\hline
\hline
Passengers & 8,1 M\textsuperscript{179} & 6,8 M & 7,0 M & 7,5 M & 7,4 M \\
Personnel & 9 981 & 10 476 & 10 847 & 11 462 & \\
Operating Profit & -19 M€ & 60 M€ & 13 M€ & 50 M€ & \\
\hline
\end{tabular}
\caption{Volume, Personnel and Operating Profit Development In Finnair}
\end{table}

Source: Finnair Annual Report 2003

\textsuperscript{178} http://www.finnairgroup.com
\textsuperscript{179} Helsingin Sanomat, December 2004
From the table the effects of cost cutting programmes can be somewhat seen at least in the number of personnel employed. The effects of low demand on the mature market and difficult competitive situation can be seen from the operating cost level. As all airlines, Finnair has gone through some difficult years during the early years of 21st century.

**Differentiation and Customer Value in Finnair**

According to Porter’s generic strategies Finnair can clearly be classified as a supporter of the differentiation strategy and it wants to hold on to the strategy with development of self-services for customers and responded to customer needs with lowering the prices of tickets and introducing new pricing principles. Alliance strategy and development of cooperation with other one world alliance members is a strong part of Finnair’s differentiation strategy. When the main strategy of the group is not changing towards low-cost strategy, Finnair has still entered the low-cost competition with a new subsidiary Fly Nordic. In most routes Finnair has kept the tactic of different travel classes, offering services for business passengers and economy passengers but not creating “lower classes” without in-flight services. The core of good customer service, according to the Finnair respondent in the personal interview, is that the customer and luggage travel in the flight booked.

In one world alliance a Customer Experience Strategy Group was formed to analyse how the alliance’s customer experience promise works in practice. After the analysis on alliance level as well as on single member airlines, several suggestions were made to improve the customer experience in the coming years. The alliances policies should create an ease, seamless and secure global travel environment creating value for
customers of the member airlines. Global support system needs development so that oneworld customers would get service wherever they are, from the member airline that is handling the service on the ground, onboard or in ticket services. Luggage services, especially tracking lost/misconnected luggage, should be increased. All front-line staff should be aware of alliance service policies and “alliance culture”. The alliance believes that benefits can be created through joint development and coordination of new products and services.

Even when the alliance as a whole concentrates on customer experience, some member airlines have been forced to introduce low-cost structure with minimum service in some routes. An example of this is the Irish national airline Aer Lingus that operates UK and Ireland based routes with low fare principles but has maintained full-service strategy on the transcontinental flights. From the European member airlines in oneworld alliance, the British Airways and Finnair have strongly chosen to differentiate themselves from competitors by developing technology for faster and more effective customer service.

The oneworld alliance membership has created savings for Finnair, especially in the form of joint procurement, increased the global connection possibilities for its customers and increased competitiveness. The Finnair Director, oneworld alliance states that there were many reasons for joining the alliance, economies of scale, possibility to enter new markets and the fact that the competitors around Finnair had already joined global alliances. He feels that Finnair has won by entering the alliance, in terms of destinations but also customers can benefit from getting frequent flyer points from all member airlines, their timetables and the use of their lounges. Shared learning and best practices have developed services in member airlines.
The company was forced to make changes in the cost structure as well as ticket prices and re-think the strategic goals. Cost savings were necessary in the competitive situation and differentiation has to be found in new ways. Customers separated more clearly into different segments and business processes need to be more variable in order to satisfy needs of different segments.

5.3. Strategic Analysis, SAS Group

As seen in the findings and interview responses, SAS Group mainly is depending on the great loyalty of Scandinavian customers, on values like transparency and openness. In order to maintain the customer loyalty, specific customer value is an area of concentration in SAS Group. Especially after industry was affected negatively by several factors, the Group changed its customer strategy. Nowadays, the group’s strategy starts from customers’ needs and concentrates on meeting the needs of different customers by diversity of services. It is shown by customer satisfaction index, which measures how customers perceive SAS’s services, and by the regular customer survey conducted every six months. As a result the group understood that most of the passengers like the self-service and preferred paying less for the tickets than before. The new strategy, started realization in 2003, has possibilities to succeed in a long-term perspective, if customer orientation is continued as a dominant strategy.

Another point, which has to be mentioned, is that the SAS group relies on its home market, Scandinavia, which is profitable even in weak business environment, and there are hidden barriers to enter this market.
Change in Strategic Focus

Considering the competitive advantage, SAS Group’s strategy until the year 2000 was similar to the differentiation-focus presented by Porter in his generic strategies and the group obviously had a competitive advantage in Scandinavian and North European market. However, beginning with the year 2000 as seen from the figure 12, the group reported regular losses in business operations and decreases in share values going onwards also in 2003.

As seen from the chart, after the year 2000, there were losses before tax 3 years in a row. Although, the administration of the Group had launched the cost-reduction programme and decided to realize it very fast, without the economic stability in business environment it would be very difficult to return to the profitable years.
Important action for 2004, was the introduction of tickets with different classes (Business, Economy Flex and Economy) to the customers. This actually gives more flexibility to the customers in choosing the flight tickets, also attracting passengers to the company, which want to pay less, but have services during travel. It was already talked about the possibility of becoming the stuck in the middle, therefore the Group has to consider focusing on specific segment of customers or utilize all its resources and achieve the highest efficiency in the industry. If this happens, there will be great industry restructuring in the European air-travel market, and possibly fast growth of the market is expected. Moreover, there were some pinpoints for such thinking. Looking at the 2004 year, beginning in June, a slight recovery in traffic was noted. Continued stabilization of traffic developments and passenger numbers are other hope-giving news.\textsuperscript{180}

So, mainly from the year 2002 on, SAS Group seems to have made changes in its strategy in order to achieve competitive advantage. Nowadays, the group drastically reduces the costs and is able to offer the low-fare tickets (very close to prices of low-fare airlines) in almost all routes. Manager of SAS Group, Star alliance stated in the interview: “SAS Group is not going to reduce costs through cancelling or decreasing the quality of services. SAS Group is a preferred choice of customers because of its services.” However, it is obvious that the strategies are now mixing into each other. The strategy concept of the Group stands between the differentiation-focus and cost-focus. This can result in the “Stuck in the Middle” position as Porter suggests. Despite this, the new low-fare concept of the group was recently launched, so it is early to speak about any results.

Although SAS Group’s officially states that year 2004 was much more successful compared to both 2002 and 2003, it is not directly

\textsuperscript{180} SAS Group homepage, Reports from 2004
showing the hidden factors of success. The reason, why the year 2004 was the best among last ones, is that, there were a lot of cost reductions made 2003-2004, including reducing the number of employees, selling the residences and leasing them, consolidation of several units and divestment of some units. These activities certainly resulted in positive cash returns and nullified mostly the losses of 2004. However, in case the consolidations will not achieve the previous efficiency or there will be need for divested units, even for employees laid-off, then the group could enter a big trouble. Moreover, serving different customer groups needs require different costs and create potential competitive threats and opportunities. Therefore, the SAS Group should avoid the potential stuck in the middle position by specifying its strategy and identifying the core customer or market segments.

On the other side, the purchase of 94% of shares of Spanair and 49% of Estonian Air could possibly bring fruits in next years. In this case, the SAS group seems to increase its competitive advantage in Baltic Sea region’s air-travel market. Considering the tourism value of Southern Europe, Spanair also could be a source for competitive advantage in that region.

The SAS Group benefits a lot from its inter-organizational relationships. Especially, as it is discussed in the empirical part of this thesis, Lufthansa, United and Varig airlines as the main partners of SAS Group, helping the airline to create an intercontinental flight network. These airlines are also members of Star alliance. The alliance has requirements concerning all member airlines and as a member of the alliance, the SAS Group cannot decide to continue with completely non-service flights. Because, the Group has to consider the alliance strategy in its business strategy and only successful incorporation of these strategies can bring competitive advantage over the competitors.
5.4. European Full-Service Airlines’ Strategic Situation

Based on the empirical findings from published sources and the personal interviews we can state that before the difficult years in the industry, there was only one business model that all European airlines followed. Networking was the key and serving business passengers was profitable so every company followed the same strategy with little differentiation to competitors. The first response to competition was creation of global alliances. Star alliance was the first large global airline alliance. The goal of star alliance has through all its existence been to create worldwide connection network for its customers and to further expand this network into new markets. Following this strategy, Star alliance has accepted more and more member airlines. The latest addition to the members has been the first national carrier accepted into an alliance, Blue1. One world alliance on the other hand has chosen a bit different strategy with not expanding its route coverage and members as much as Star alliance but instead concentrating heavily on customer experience and technological development.

Differentiation has clearly been chosen as a source of competitive advantage by many traditional airlines that do not want to compete in price category only. But sources of differentiation have changed in the industry when customers needs and price-sensitivity has changed. Creating good connection and offering frequent flyer benefits is not enough for today’s air-travel passengers. The different segments have moved further away from each other and represent different needs. This means that traditional network airlines have been forced to lower their prices and to target smaller customer groups in more specific ways. When previously
airlines were very similar, today they are required to distinguish themselves from others and lay out better offers than competitors.

The following figure shows how the different airline groups, low-cost airlines, charter airlines and network airlines are positioned in relation with each other. The variables measured in this positioning chart are the service level compared to the unit cost but also the segmentation of customers into smaller groups and complexity of the business model.

![Positioning of Airlines](image)

*Figure 13: Positioning of Airlines*

Source: Franke 2004, Journal of Air Travel Management

The positioning figure was created by Franke to present the relationships between different types of airlines and their products. Franke has in his studies generalized this model to describe most of the airlines, in both European and American markets. The figure shows how low-cost carriers offer very low prices on special rates but also higher rates that rise higher than the low-value continental rates of network airlines. When these airlines grow in size and network, and start to use some of the main airports
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in Europe, they will move very close to the traditional airlines’ business model. The area where network airlines compete has grown and a variable business portfolio is needed.

In the industry this means that traditional airlines can make different choices about the strategic direction they wish to take. All airlines have been forced to lower their costs and prices, so the business model cannot continue unaffected. According to the studies in the area Franke has suggested three ways in which full-service airlines can develop; to change the costly hub-based model of central airports and reduce the network connectivity, to offer specific services targeted to different customer segments, or to alter the customer interface by industrializing service tasks and introducing developed service technology. The three choices can be seen from the following figure:

Figure 14: New Business Models for Traditional Airlines
Source: Franke 2004, Journal of Air Transport Management

On the basis of findings and analysis in this thesis SAS Group and Finnair seem to be moving into different business models. This is also reflected by the development of Star and oneworld alliances. SAS Group along with other major member airlines of Star alliance have chosen to
offer “something for everyone” (choice C in the figure) by offering several ticket classes. Finnair along with British Airways and other members of oneworld alliance have chosen to concentrate on the customer service and internal processes, moving towards the simplified model, presented as choice B in the figure 12.

Many airlines, including the SAS Group and Finnair Group, have entered the competition of low-cost travelers with starting their own subsidiary-based on light cost structure and efficiency. This does not however change the main strategy of differentiation that the traditional airlines have chosen to follow. The traditional airlines as a whole cannot be altered into low-cost airlines because of their completely different operational structure. Still the strategic decisions need to be more complicated and customer segments targeted more carefully. Following clearly one of the two generic Strategies is becoming history also in the airline industry. Porter originally stated that the two strategies could not be combined but as later noticed in many industries; today they need to be mixed and thought over. Relying on one strategic principle is not enough to create competitive advantage over competitors.

The future growth for European airlines is predicted to arise from the East European countries, such as Russia and the new European Union countries, including Estonia, Lithuania, Latvia and Poland. Another strongly growing area is Asia. In Europe many airlines have opened new routes to Asian cities. The economic growth in those areas is fast.

The low-cost airlines also have plans to grow bigger and expand their business. Low-cost operations are at present fastest growing area of air-travel in Europe. Scheduled flight operations are predicted to grow by four per cent per year, charter flights by four or five per cent, regional operations by eight or nine per cent and the low-cost operations by 20%. Both Ryanair and easyJet have ordered a large number of new
aircraft, which means they will need to create new routes. They are also looking towards the Northern Europe, the home markets of Scandinavian Airlines and Finnair.\textsuperscript{181} New entrants in the North European markets are also not a new phenomena, already eight different low-cost operators have entered the market in Finland and out of those only four still survive after an only short time period.\textsuperscript{182}

\textsuperscript{181} Ahola 2003
\textsuperscript{182} Suila 2004
6. Conclusions

Strategic alliances have taken an essential part in the competition strategies of European traditional full-service airlines. Creating networks became a necessity in the industry, in order to survive among market leaders and low-cost operators. In the beginning of the 21st century, the European traditional airlines were forced to realize that the network creation was not enough to built competitive advantage as all the other airlines developed their networks also. Customer value became very important, airlines had to evaluate what did their customers really need and value.

The airline customers value speed in services, less waiting at the airports and convenience. The basic values, security and punctuality, are still the ones that remain at the top of the list.

What the traditional airlines did was to lower the ticket prices, rethink the travel classes and developed innovative technology solutions to self-service and online sales. Heavy cost cutting programs were introduced in all major full-service airlines in Europe. The airlines still believe in the future of alliances and also develop their connections networks according to demand and the world economic situation.

Star alliance and oneworld have developed in different ways. Star alliances has grown the number of member airlines and in this way created a wide network that offers shared frequent flyer benefits. Oneeworld alliance has not increased the number of member airlines but has increased the level of cooperation, especially in development of customer service and technological solutions. The development in alliances has not been enough to create competitive advantage and airlines have chosen different business models. There have been three possible reactions of the traditional airlines,
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Reducing the connections and hubs, rethinking the customer services and efficiency or moving towards more tailor-made services, aiming at attracting various customer segments.

Both case companies, Scandinavian Airlines (SAS Group) and Finnair, reported losses at the end of the year 2003. For the following year they still expect to report losses but less than before. Both airlines look into the future with confidence and see potential growth in the Scandinavian market as well as Eastern Europe and Asian destinations. Both companies have made strategic decisions, which brought structural and strategic changes in the groups’ operations.

Cost-reduction programme of SAS Group and several joining activities within the group should lead to the increase in efficiency. In this way, the group can benefit from the both markets: to offer to customers serviced flights with lower prices than prices of traditional full-service airlines, on the other hand, attract other passengers by offering service at the same price with the low-cost carriers, taking advantage of attracting a lot of passengers. The new business concept of the SAS Group will be revolutionary step in the change of air-travel industry. However, the risk of “stuck in the middle” position between full-service and low-cost airlines also remains. To avoid this, the SAS Group could consider focusing on particular customer segments. If alliance relations are correctly used and shared assets are maximum utilized, the cost reductions within the group will certainly have an impact on the profitability of future years.

Finnair group has gone through major cost cutting program, evaluations of internal processes, customer service changes especially by introducing online and self-service systems. The fleet has been renewed to increase efficiency because the fuel costs create the biggest single cost for airlines. Information technology development and joined customer service development efforts within the one world alliance can enhance Finnair’s
position among the leading companies in new technologies. This does not limit to customer services but increases efficiency in internal processes as well. Compared to the losses made by the competitors around the company, Finnair has reported relatively small losses and is therefore expected to recover the profit level faster than many larger airlines.

Operations of both full-service airlines and low-cost airlines are moving closer together but choices of business model have become more variable than in the past. The airline customers hold the power and there are a lot of different services to choose from. The industry continues to be dynamic and rapidly changing. All the strategic decisions made by different airlines may not turn out to be profitable. For further study the authors recommend similar close analysis of other European airlines in the busy central European routes. A customer research that truly measures the changing values of different customer groups should also create valuable insight for the future direction in the industry.
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**Personal Interviews:**

1. Sucksdorff Mika, Finnair, Director, Alliances
   Interview in Helsinki, 1st December 2004

2. Möller Kim, SAS Group, Vice President Alliances and Partnerships
   Interview in Stockholm, 15th December 2004
APPENDIX I

**Interview Questions**

1. What does good passenger service mean in airline business today?

2. Do alliances increase the level of service quality for member airlines?
   Yes / No

3. What are the main benefits of alliance membership for a single airline?
   1. ______________________________
   2. ______________________________
   3. ______________________________

4. Which positive and negative effects have the cheap airlines had on the European market?
   + ______________________________
   - ______________________________

5. In your opinion, are traditional airlines moving closer to the low-cost airlines strategy?
   Yes / No

6. What are the airlines experiences of online and self-services, are they a growing part of airline passenger service?

7. Are alliances going to develop stronger cooperation in the future?
   Yes / No
   How?

8. Many experts have predicted that only few airlines will survive in the European market. How do you see the market in the future and your company’s role in that after 8 years?