Strategic Alliances
Implications for low-cost airlines

Master’s thesis within Business Administration
Author: Lisa Gustafsson
Therese Simberg
Tutor: Veronica Gustavsson
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Abstract

Background: After the deregulation of the airline industry new actors entered the market and among them were the low-cost airlines. These actors are not involved in the same traditional airline alliance used by the traditional airlines to strengthen their position on the market.

Problem and purpose: Little research has been made regarding the benefits for low-cost airlines to engage in strategic alliances. The purpose of this thesis is to evaluate if low-cost airlines benefit from engaging in strategic alliances or collaborations, and identify possible alliance configurations.

Method: To fulfill the purpose we have used a qualitative method and case studies. Interviews with respondents from two low-cost airlines as well as an airline industry field expert were used to gather information about the thesis subject.

Conclusion: We have concluded that the low-cost airlines in this study benefit from engaging in strategic alliances. The low-cost airlines are using vertical as well as horizontal alliances principally to gain cost-reduction or efficiency benefits. Both cases were against traditional airline alliances due to the high costs involved, and the fact that they do not share the same motives for alliances.
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1 Introduction

The introduction provides the reader with a background to the subject of the thesis and with a problem discussion. The purpose of the thesis is presented followed by a statement of the research questions and a disposition of the thesis.

1.1 Background

The airline industry has previously been a heavy regulated industry with partially state-owned airlines and controlled competition across borders. This put the traditional airlines in a comfortable position in their domestic markets as new entrants were few due to regulations and other barriers. In the early 1990’s the Swedish and European airline industry was deregulated. This resulted in a changed state of competition with new market entrants domestically as well as from other countries (Vaara, Kleymann & Seristö, 2004).

Many of the new entrants are the so called low-cost airlines that strive to be cost efficient and keep low prices. They have been called point-to-point airlines, no-frills airlines, low-cost carriers and low-fare airlines (cf. Littorin, 2004; Binggeli & Pompeo, 2002). Throughout this thesis the term low-cost airline will be used. A low-cost airline is an airline offering low fares for point-to-point traffic, with fewer services than a traditional airline (Wikipedia, 2005a). A traditional airline offers destinations domestically and internationally with a wider range of services. This differentiation is made easier by their extended network of airlines in form of strategic alliances (Wikipedia, 2005b).

Today the traditional airlines also offer low-fare tickets and thereby it can be confusing where the line is drawn between a traditional and a low-fare airline. The term low-fare only refers to the price whereas the term low-cost involves trying to keep low costs throughout the whole organization and the processes involved. The major competition on the Swedish market is on the high-traffic routes and it has accelerated in the last years with the new actors entering in the low-fare segment of the market (Littorin, 2004). Scandinavian Airline System (SAS) has further increased competition by restructuring its ticket-fare system and now offering a number of tickets to a similar low-fare as the low-cost airlines (Orring, 2005).

Today almost all traditional airlines are involved in some kind of strategic alliance. According to Kleymann and Seristö (2001) it is not a question whether to join a strategic alliance but rather when to join, taking this step for granted. Little focus has been put on low-cost airlines and their relation to strategic alliances. They are relatively new actors on the European market, which could be a reason for the little focus that has been put on them. On the US market these actors have been present a longer time, such as Southwest Airlines, but we have found little research regarding their involvement in strategic alliances. The large airline alliances1, such as Star Ali-

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1 See appendix 2
ance, One World Alliance and Sky Team, only include one low-cost airline owned by a larger traditional airline. There are a number of low-cost airlines not involved in traditional airline alliances\(^2\). These airlines could be involved in other types of collaborations or alliances but we have not found specific research concerning this subject.

### 1.2 Problem Discussion

Having this background in mind, Lewis (1990) states that there are four ways in which a company can strengthen their competitive position; through internal activities, acquisitions, arm-length transactions and strategic alliances. A lot of research has been made on firms using strategic alliances to become more competitive. A new actor on a market can become competitive and successful faster than it would have on its own when engaging in strategic alliances (Hamel, Doz & Prahalad, 2002).

The low-cost airlines can be viewed as relatively new entrants on the Swedish market, which implies that strategic alliances can be a useful mean in order to become competitive. By the term strategic alliances we refer to strategically planned collaborations with one or more partners, with the intent to become more competitive and it must be mutually beneficial. This definition is in accordance with that of Spekman, Forbes III, Isabella and MacAvoy (1995), and Agndal and Axelsson (2002).

The large traditional airlines have a history of engaging in strategic alliances. These have been alliances concerning for example flight bookings, procurement and maintenance of planes and purchase of fuel (TT, 2003). The traditional airlines have received benefits in the form of extended networks and cost reductions from sharing ticket sales operations, maintenance, staff and investments.

As mentioned above, a strategic alliance can help an airline strengthen its competitive position by collaborating with competitors on specific terms. The case could be that low-cost airlines will be forced to collaborate with competitors in order to stay competitive. Michael O’Leary, president of Ryan Air, disagrees and states in an interview that low-cost airlines should not engage in strategic alliances as the concept is to compete against every actor on the market. He also predicts that in a few years there will only be three large alliances and one low-cost actor on the market (Blomgren, 2003).

### 1.3 Purpose

The purpose of this thesis is to evaluate if low-cost airlines benefit from engaging in strategic alliances or collaborations, and identify possible alliance configurations.

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\(^2\) See appendix 1
1.4 Research Questions

From the purpose mentioned above we have identified the following research question to help us focus better and fulfill our purpose:

- What type of collaborations or alliances are the low-cost airlines involved in?
- What benefits, costs and risks are involved in these alliances?
- Are there any differences between the alliances of traditional airlines and the possible alliances of low-cost airlines?
1.5 Disposition

Chapter 1: In the introduction chapter we present a general background with interesting issues in the airline industry. This leads us to a more specific problem discussion and further we state the purpose. The chapter ends with our research questions.

Chapter 2: The frame of reference is built upon three main areas; strategy, strategic alliances and the airline industry. The three theoretical areas are linked and our underlying theoretical propositions are presented and then used as a basis for the collection of empirical data.

Chapter 3: In the method chapter, how the research was conducted to obtain valid and trustworthy results is described.

Chapter 4: The empirical data was collected with the theoretical propositions as a basis. A description of the dominant themes brought out of the data is further presented.

Chapter 5: In the analysis the dominant themes are linked with the theoretical framework.

Chapter 6: In the last chapter the conclusions drawn from our analysis are presented. We end with a discussion regarding areas for future research.
2 Frame of Reference

The frame of reference aims to provide a base of knowledge and a presentation of previous research concerning the subject of the thesis. The chapter treats three main areas; Strategy, Strategic Alliances and the Airline Industry. At the end of this chapter we link the three areas together to create our theoretical proposition.

In the introduction we identified strategic alliances between low-cost airlines as the main area of interest and therefore we need to establish some sort of theoretical foundation in order to help us gain a deeper understanding about the relevant subjects. It goes without saying that we need to examine the phenomenon of strategic alliances and while touching the term strategy we shall take a closer look at what the most important and widely recognized theories on strategy might give us. As our topic is concentrated within the airline industry it is also important to further clarify the characteristics of that particular industry, and how strategic alliances previously have been used by traditional airlines.

2.1 Strategy

In an organization strategy can be identified and treated on different levels; corporate, business unit and operational. The corporate strategy treats the purpose and scope of the whole organization and strongly takes the stakeholders into consideration (Johnson & Scholes, 1999). The strategic decisions taken on corporate level in turn influences the strategies on the other levels, but these levels break the strategy down to fit their level. This study will mainly focus on strategy at corporate level as our subject concerns strategic decisions concerning the full scope of an organization. We have chosen to use the research and theories of Porter as we want a basic strategy approach that connects strategic choice with gaining competitive advantages. Porter’s research is concerned with identifying what strategies works best in certain circumstances, in order to choose a competitive strategy that enables the firm to gain competitive advantages (Kippenberger, 1998).

Hamel and Prahalad (1994) stress that with a common strategic intent, motivation and enthusiasm in the organization can be enhanced. Strategic intent is a conception that should be treated at corporate level and it is defined as; “...the desired future state or aspiration of the organization” (Johnson & Scholes, 1999, p. 243).

The strategic intent communicates a certain sense of direction on a long-term basis regarding what competitive position the company aims to build. It also provides a sense of discovery as the employees are allowed to explore new competitive territory. The risk of not having a common strategic intent is that the members of the organization start to pull in different directions (Johnson & Scholes, 1999). Hamel and Prahalad (1994) mean that creativity should be encouraged but at the same time controlled so that it is focused in the right direction.

A strategic decision takes several aspects into consideration such as the long term direction of the organization, how to achieve a competitive advantage against competi-
tors, the boundaries for the organization’s activities and the strategic fit (Johnson & Scholes, 1999). The strategic fit is defined below:

“Strategic fit sees managers trying to develop strategy by identifying opportunities arising from an understanding of the environmental forces acting upon the organization, and adapting resources as to take advantage of these” (Johnson & Scholes, 1999, p. 23).

2.1.1 Porter’s Generic Strategies

Porter (1985) claims that there are two basic types of competitive advantage a company can have; low-cost or differentiation. When combining these two competitive advantages with the scope of activities of the company, the results are three generic strategies; cost leadership, differentiation and focus. These are shown in figure 2-1. Porter (1985) means that each strategy has a competitive advantage but the firm has to make a choice regarding which advantage they ought to seek.

![Diagram of Porter's competitive strategies](image)

Figure 2-1 Porter’s three generic strategies to gain competitive advantage (Porter, 1985).

When a firm adopts the cost leadership strategy it strives to be the low-cost provider in a specific industry. Techniques to become cost leader can be economies of scale, preferential access to raw materials or special technology. A low-cost producer distributes a standard or no-frills product and the challenge is hence to find and exploit cost advantages everywhere possible (Porter, 1985).

The differentiation strategy concerns knowing what main dimensions the industry buyers value, and to be unique compared to others in these dimensions. If a company is unique in relation to the special attributes valued by customer a higher price can be set for that product. The differentiation attributes can be based on for example the product or how it is distributed. For this strategy there can be more than one differentiation strategy in a specific industry that is successful (Porter, 1985).

Porter (1985) mentions the risks of completely ignoring differentiation when focusing on a cost leadership strategy. If a company is to succeed with the cost leadership
strategy the product or service has to be comparable to those of the competitors. If it is not comparable to a certain standard the company will be forced to lower their prices much lower than competitors to gain any sales which is not the purpose of the cost leadership strategy. On the other hand, if a firm can achieve cost leadership in differentiation at the same time it will experience additive benefits as it can charge at premium price, and at the same time have lower costs.

Both cost leadership and differentiation strategies try to find competitive advantages in a broad range of segments in an industry. The third strategy, focus, differs from the other in the way that it is about choosing a segment on the market and only focus on that segment. By doing so the firm can be the cost leader or differentiated towards that segment and hence gain a competitive advantage but only towards that specific segment. It is important when trying to succeed with a target segment, that it is significantly different from other segments and that it has potential (Porter, 1985).

If a firm engages in all three generic strategies simultaneously, and not succeed in any of them, Porter (1985) refers to them as stuck in the middle. Other companies that have a sustainable competitive advantage will in the long run take over. A company stuck in the middle faces the difficulty of how to compete and thus tries to find a competitive advantage in numerous different ways, and through this compromises its strategy. Instead the firm should find new industries in which to grow and pursue a generic strategy, or exploit their interrelationships (Porter, 1985).

Klein (2001) presents critique towards Porter’s widely acknowledged theory about how to gain competitive advantage. He claims that the term competitive advantage is simply a quality that brings about success, and not something that can be easily identified. He further claims that the theories of Porter regarding the generic strategies are not theories treating the depth and complexity of organizations. This study simply aims to use the theories regarding competitive advantage and generic strategy in order to help link the strategic choice with type of alliance or collaboration, and not go deeper into the field of how to gain competitive advantage.

2.1.2 Porter’s Five Forces

By studying the surrounding environment of an organization it is possible to determine the competitive state of the industry in which it operates. Competition depends on five forces shown in figure 2-2, and these forces determine the profit potential of an industry (Porter, 1980).

The threat of entry depends on how easily new actors can enter the industry which in turn depends on the barriers to entry. The barriers to entry are; economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scale, and government policies. In an industry where economies of scale can be obtained, a new actor will not be able to offer the same low price since economies of scale are the decline in unit cost as the total volume increases over time. Product differentiation is a matter of customer loyalty towards the brand of a traditional firm that forces a new firm to spend heavily on creating their own brand recognition. If large financial investments are needed to enter the
industry this poses as a disadvantage for new firms. This is especially true for risky investments made in R&D or advertisement that will not return anything if the entry would fail. Switching costs are one-time costs for the buyer if it chooses to switch from one supplier to another for the same product. If a new entrant is not accepted by or allowed into the traditional distribution channels market entry is likely to fail. Cost advantages independent of scale are advantages that new entrants can not copy or obtain by size or economies of scale, such as know-how or preferential government subsidies. Government policies can pose as large barriers to entry by controlling licensing requirements and raw materials (Porter, 1980).

![Figure 2-2 Porter’s five forces affecting the industry competition (Porter, 1980).](image)

The firms already in an industry are said by Porter (1985) to be mutually dependent. When one firm takes action to improve its competitive position in the industry this intensifies the rivalry and the competitors feel the need to retaliate. There are different ways to retaliate such as engaging in price wars, adding attributes to the existing products and services or more advertisement. The firm that made the first move to enhance its position might find itself in a worse situation after the intensified rivalry than when they started (Porter, 1980).

Basically all firms face the threat of substitute products. A substitute product is not necessarily an identical or similar product or service but something that can perform the same function the firm’s product. If a whole industry faces a threat of substitution from another industry it can perform a collective action against that industry. If all firms in the industry promote their products and services, this might improve their industry’s position against the substitute industry (Porter, 1980).
Buyers can have a strong bargaining power under certain circumstances. If they are a large group joining forces or just one buyer purchasing large quantities, they have the possibility to influence the price, service, and quality and thus the profits. Suppliers can have a strong bargaining power if the industry is very dependent on them. If an industry can not substitute the product or service of a supplier, the supplier could threaten to raise the price or lower the quality and thus pose as a threat (Porter, 1980).

2.2 Strategic Alliances

In the context of research, relationships between firms can be seen as networks or alliances. Different researchers have different ways to categorize networks and Agndal and Axelsson (2002) distinguish between alliance networks and naturally emerging networks. An alliance network is formed when companies deliberately create an alliance, having the same purpose in mind and working towards a common goal. To enter an alliance network the firm has to adapt to the alliance’s codes of conduct and be accepted by all existing members. The naturally emerging network is not as clearly or easily defined. Contrary to the alliance network the naturally emerging network is not created with a specific purpose in mind but it evolves over time. When mapping out this type of network it is important to put it in a context. For example a company has one network involving all its stakeholders and another one related to a certain product or market. It is easier to join a naturally emerging network as it has fewer barriers to entry and a new member only has to be accepted by one of the existing members (Agndal and Axelsson, 2002).

This study focuses on deliberately created networks or alliances similar to what Agndal and Axelsson (2002) refer to as an alliance network. These are often referred to in research as strategic alliances and can be defined as:

“a close, long-term, mutually beneficial agreement between two or more partners in which resources, knowledge, and capabilities are shared with the objective of enhancing the competitive position of each partner” (Spekman et al., 1995 p. 4).

Collaboration between firms can create value through vertical or horizontal arrangements (Contractor & Lorange, 2002). According to Shiva (1997) horizontal alliances are between competing firms collaborating to develop new technology or penetrate new markets. A vertical alliance is about integrating the company value chain, both downward and upward. The traditional airline alliances are typical examples of horizontal alliances while franchising is a typical vertical alliance. Contractor and Lorange (2002) mention vertical quasi integration as an agreement where the partners contribute with one or more different elements, making them complementary partners, instead of similar partners. If partners provide similar inputs to the collaboration the motives can be to limit excess capacity, reduce the risks through joint efforts and reduce costs.
2.2.1 Strategic Alliance Objectives and Benefits

The reason for joining in a strategic alliance is to gain benefits that one could not achieve by working alone (Spekman et al., 1995). Even if companies share the same objectives and goals, there is no need for a strategic alliance if they do not need each other to reach them.

Regarding alliance objectives, Koza and Lewin (1998) make the connection to March’s (1991, 1995) studies on exploration and exploitation strategies regarding organizational learning. They propose that firms creating alliances can have exploitation or exploration objectives and the choice is depending on their strategic intent. The exploration objective is concerned with discovering new possibilities to increase revenues, or simply exploring for new opportunities. Exploitation objectives are aimed at increasing productivity of employed capital and assets, standardizing and systematic cost reduction, which involves exploiting existing capabilities. Levintahl and March (1993) argue that a company that only focuses on exploration faces the risk of never getting any returns from the knowledge gained. If a company focuses too much on exploitation of existing knowledge it faces the risk of becoming obsolete. The need of a balance between the two objectives can be described as;

"The basic problem confronting an organization is to engage in sufficient exploitation to ensure its current viability and, at the same time, to devote enough energy to exploration to ensure its future viability." (Levinthal & March, 1993, p. 105).

Koza and Levin (1998) mention joint ventures and network alliances as typical exploitation alliances in which the partners jointly maximize assets. Learning alliances represent a typical exploration alliance where one party invests in the discovery process and gets an equity option in return. Learning alliances include learning from the partner and does not involve the joint utilization of assets like in the case of alliance networks. The benefits from engaging in either an exploiting or an exploring alliance further depend on what type of industry the firm is operating in. In stable industry environments and markets the firm can gain competitive advantages by focusing on exploiting existing capabilities. This same exploitation strategy can in a changing environment lead to what Koza and Levin (1998) refer to as a competency trap, which has a negative effect on the firm’s survival. This implicates that firms have to recognize what type of industry they are in and act accordingly.

When the motives for forming strategic alliances have been reviewed we further discuss the benefits that can be derived from these activities. Contractor and Lorange (2002) state the following benefits that can be achieved:

Risk reduction is a common benefit in research-intensive industries where the costs for development are high. The benefits are derived from spreading the risk of a certain project over more than one firm, diversifying the product portfolio, speeding up market entry and raising profitability faster, and finally cost reduction (Contractor & Lorange, 2002). Haspeslagh and Jemison (1991) state that alliances are often created as a first step towards a merger or an acquisition. Mergers and acquisitions are expensive and therefore an alliance is less risky and enables the partners to establish trust and share information before a possible merger or acquisition.
Economies of scale and rationalization are possible benefits from engaging in strategic alliances. Collaboration can increase the volumes being handled in the companies and thus lowering the average unit costs. Two partners having comparative advantages can achieve benefits and cost reduction from taking advantage of each others comparative advantages (Contractor & Lorange, 2002).

Technology exchanges involve using the partner’s complementary technology to achieve synergy effects. Joint ventures can be beneficial to reach new markets or take advantage of patent rights not possible to obtain without collaboration (cf. Contractor & Lorange, 2002; Spekman et al. 1997; Whipple & Gentry, 2000).

Co-opting or blocking competition are motives for collaborating, which can be of a defensive as well as an offensive nature (Contractor & Lorange, 2002). When using a strategic alliance to access or to create new markets, adjust to government regulations or steal market share from competitors the company uses an offensive alliance strategy. A defensive alliance strategy can instead be used when protecting the company’s current market share or position (Spekman et al., 1995).

Overcoming government trade or investment barriers is said to be the most common motive for joining a strategic alliance. If government rules or barriers prevent a company from establishing in another country, a joint venture or an alliance is a common way to overcome that obstacle (Contractor & Lorange, 2002).

Facilitating initial international expansion of inexperienced firms is a benefit when using joint ventures or alliances (Contractor & Lorange, 2002). Time and money are two large constraints when a company tries to develop a new product or enter a new market. By entering in a strategic alliance a company can become competitive and successful faster than it would have on its own (Hamel et al., 2002).

2.2.2 Strategic Alliance Success Factors and Risks

When forming an alliance there are several aspects that need to be thoroughly considered such as the costs and risks. When contemplating whether to form a strategic alliance, the value chain is analyzed to see where it might be valuable to cooperate. Since collaboration might be costly it is important to weigh the costs against the possible benefits (Spekman et al., 1995). Whipple and Frankel (2000) mention the most important factors influencing alliance success to be; trust, senior management support, ability to meet performance expectations, clear goals and partner compatibility. These are displayed in figure 2-3.
Figure 2-3 Alliance success factors. (Whipple & Frankel, 2000, p. 23)

**Trust**

Koza and Levin (1998; Whipple & Frankel, 2000) refer to trust as the magic ingredient for an alliance to succeed. They further state that different partners have different views on trust and what it entails, and it is the fit between alliance intent and type of alliance that determines the level of trust.

**Senior Management Support**

Not all managers at companies involved in alliances like to be dependent on others to be competitive or to succeed. This may cause problems and tension in alliances since many alliances in fact consist of competitors trying to collaborate. It could be that the wrong partners were chosen when planning the alliance or that the wrong people were chosen to run it. To avoid this type of problems the alliance must be thoroughly planned and controlled. Since the alliance is built on trust, invading that trust and stepping over defined boundaries will create problems (Spekman et al., 1995; Whipple & Frankel, 2000).

**Ability to Meet Performance expectations**

When forming an alliance it is imperative that all partners agree upon what each member should contribute with, what value they bring and how to share the profits arising from the alliance (Spekman et al., 1995; Whipple & Frankel, 2000). If the companies do not have shared objectives with the strategic alliance the collaboration will never be successful. This might in theory seem like an easy thing to agree upon but in real life every company holds its own specific objective it wants to achieve (Lewis, 1990).

**Clear Goals**

If the goal with the alliance is to create value all parties must have an equal understanding of what each partner should invest and expect in return (Lewis, 1990;
Whipple & Frankel, 2000). To strengthen the commitment between the members of the alliance it is important that risks and benefits are shared. If one company does not invest any capital or knowledge or take any risks, it is not likely to work as hard for the common goal (Lewis, 1990).

Partner Compatibility

An alliance is likely to fail if expectations differ too much or if there is a lack of trust between the alliance members (Spekman et al., 1995; Whipple & Frankel, 2000). An alliance can only exist as long as a mutual need exists. As soon as one partner’s value diminishes the others will leave or take over the alliance (Lewis, 1990). When choosing suitable partners the corporate culture becomes important. It is important that the partners have common goals and that the corporate cultures are somewhat compatible (Spekman et al., 1995).

2.2.3 Risks and Concerns

Hamel et al. (2002) state that some researchers look at the longevity of an alliance to determine its success, and instead they look at the shift in competitive strength on each side. The focus is on how companies can enhance their internal skills and technology with a strategic alliance without transferring their competitive advantages to their collaborating competitors. Hamel et al. (2002) have four principles they have recognized in successful alliances. They state that collaboration is competition in a different form and thus it is important to remember that the partners chosen are in fact competitors and they can have an alternative motive for collaborating. To be successful the company has to enter the alliance with a clear objective and also be aware of its partners’ objectives. They further state that harmony is not the most important measure of success. Hamel et al. (2002) argue that a partnership never experiencing conflicts is not always the best and that very few alliances remaining in a constant win-win situation. It could be that occasional conflicts are proof of a mutually beneficial collaboration. Cooperation has limits and companies must defend against competitive compromise, meaning that a company may have set rules at top management level of how the alliance should be handled and what information should be shared. Since the information and technology is mostly shared on an operating level these employees must be informed about what they are allowed to share. A successful company also keeps track of what has been shared with the partners and what it has requested to be shared.

Finally, learning from partners is paramount which means that a company chooses its partner because they have valuable capabilities and thus has to take advantage of that knowledge. A successful company uses the alliance to learn from its partner and then uses that knowledge to create value for their own purpose only. A negative aspect of this is that the company is forced to give up a part of its own autonomy and control. Hamel et al. (2002) emphasize the importance of learning and sharing, but further stress the value of containing the own competitive advantage. Too much sharing will undermine the own competitive advantage. Frazier, Spekman and O’Neill (1988) state that permeability is to what extent organizations allow information, knowledge and technology flow between them. The interfaces are the points where the members
of an alliance interact and exchange value, information and knowledge. There are both formal and informal interfaces and formal interfaces are the agreed upon control mechanisms in the alliance such as board meetings and contracts (cited in Spekman et al., 1995). The informal interfaces are described by Larson (1992) as the glue holding the alliance together. Davies (2001) also states that for a strategic alliance to work the partners need to actively and openly share privileged information. They should not only share technology and information but also their strategic goals and how they will achieve them. Koza and Levin (1998) refer to the firm’s ability to utilize outside knowledge and apply it to themselves as the firm’s absorptive capacity.

2.3 The Airline Industry

The airline industry is considered to be different compared to other industries. Watson (1997) states that;

“for no rational reason, the aviation industry is not game to be like any other industry. A lot of [airline] companies are still government-owned and much of the trade in aviation services is still controlled by governments” (Watson, 1997, p. 22).

The airline industry has traditionally been a heavily regulated and government controlled industry since the beginning more than 80 years ago. In Europe the governance has been especially evident as the political agenda of the governments controlling or partially owning the airlines has affected the profitability in the industry. When the governments have been building up an infrastructure airlines have been forced to fly jet aircraft service to small towns (Vaara et al., 2004).

In 1978 the US air traffic was deregulated and liberalized. In Europe the European Union was the force that deregulated the airline industry in 1993 through the third air traffic package. A similar deregulation had already been carried out in Sweden in 1992. The third air traffic package aimed to create a market with free competition, free market entry and free pricing (Luftfartsverket, 2004). The free market entry together with the free pricing made it possible so that the airlines only had themselves to answer to for making their companies profitable (Luftfartsverket, 2001). These new terms of competition were very different and the companies that earlier had strategies focusing on building up nation infrastructure and safety had to compete on the same terms as other industries.

2.3.1 Low-Cost Airline

In the background we mentioned that we will use the term low-cost airline. We will further provide a more detailed description of what this term includes. The on-line dictionary Wikipedia (2005a) describes a low-cost carrier as an airline that offers low fares but eliminates most traditional passenger services. The low-cost airline normally has only one passenger class and one type of plane. Low-cost airlines often use yield management, meaning that fares increase as the plane fills up by reservation, and thus early reservation is rewarded. This type of airline often flies to cheaper or secondary airports and only short, point-to-point flights with fast turnaround times. Tickets are often sold on the Internet, which cut down administrative costs. It is common that
employees such as flight attendant perform many duties like cleaning the aircraft or attending the gates.

2.3.2 Strategic Alliances in the Airline Industry

The airline industry today is very turbulent and many airlines form alliances. According to Kleymann and Seristö (2001) an airline is no longer contemplating whether to join a strategic alliance but rather about which to join with and what the alliance should include. Mockler (1999) states that strategic alliances are especially common in the airline industry and he explains this by the following factors.

- Travelers are not satisfied with just flying or traveling domestically, but they want to be able to reach all parts of the world.
- There are extensive government regulations regarding governing landing rights, cross ownership and route structures.
- The organization of airline hubs and centralized based airline routes.
- The nature of the promotion and selling requirements, often done by telephone, Internet or through independent agents.
- The capital investments necessary in the airline industry are high.

Kleymann and Seristö (2001) mention two objectives for entering an airline alliance; efficiency-seeking or market-oriented. The market-oriented objective can further be divided into market-defensive and market-offensive. A defensive objective can be to try and tame competitors, and this is achieved by entering an alliance with that competitor. The term entrenchment is used to describe a defensive market objective. This is when an airline strengthens its position on the home market by linking the home market to the world market and thereby becoming more attractive to newcomers in the region. Market offensive objectives can be to create value enhancement of the product by offering for example the possibility of a connection or link to an extensive route system. Value enhancement can also be derived from a linkage to another airline’s brand or the brand of the alliance itself, or by learning from the partner regarding revenue management or marketing. An offensive move can also be to get access to a central hub where an alliance is dominating. If the alliance objectives are efficiency-seeking these are obtained by joint resource utilization or economies of density. Economies of density are gained when increasing the occupancy rate or load factor on a flight because of passengers fed from partners. Further objectives can be to gain control over the surrounding environment i.e. control over suppliers or authorities, which a single airline is unlikely to be able to do by itself (Kleyman & Seristö, 2001).

Kleymann and Seristö (2001) point out three specific benefits that can be gained from airline alliances. These are:

- Market-presence related: These benefits are primarily related to augmented revenues due to the operation of more routes or higher load factor.
• Resource-utilization related: These derive from labor productivity, aircraft productivity or lower costs of acquired goods and services.

• Learning of practices: These are an indirect way to gain benefits, but in the end they result in financial benefits in terms of better productivity or higher revenues.

According to a research study on airline alliances made by Vaara et al. (2004), basically all larger international airlines are involved in alliances of some sort. Although alliances first became dominant as airline strategy in the 1990’s in Europe, they have been around much longer. SAS was the first airline in Europe to develop a strategy concerning alliances and claimed this was necessary for smaller airlines to compete against the large carriers on the market. The survival of alliances has long been discussed as the industry was very volatile in the early 1990’s, with alliances forming one day and ending the next. According to Lindquist (1999) about 70 percent of all alliances created in the late 1990’s had survived which could indicate a change in the volatile trend (cited in Vaara et al., 2004). The research by Vaara et al. (2004) also suggest that joining a strategic alliance has been an inevitable strategic choice for airlines. In 2001 British Airways motivated their choice to cooperate with others by the following statement in their British Airways Fact Book:

“More people want to fly to more places more easily and for greater value. Regulation or economics makes it impossible for any one airline to serve all these markets. In the drive for greater efficiency (as a means of providing greater customer value) airlines have largely achieved internal cost savings where they can. Future efficiencies will come from working more closely together, which means greater cost savings for the customer” (Vaara et al, 2004, p. 14).

Ownership within the airline industry has always been heavy regulated. The possibility for one airline to invest in another airline company outside their own country is and has been limited. This regulation has been a large contributing factor for the creation of alliances in the past decades. With regard to the above quote from British Airways, Vaara et al. (2004) argues that due to regulations, airlines find cooperation to be the only realistic option when it comes for larger airlines to grow internally. The CEO of Finnair gave his view on the connection between alliance building and government regulations:

“The explanation for alliances is very simple. Air traffic is so much regulated that even large airlines can’t manage only by adding flights. One must ally, because customers demand global service” (Vaara et al., 2004, p. 14).

Most of the traditional airlines have joined alliances to avoid over-competition. Despite the possible advantages from this they have expressed the difficulty of being involved in an alliance. Being involved takes up a lot of time at coordinating meetings to run the alliance and a small airline does not have the time or money for it (Vaara et al., 2004).

Initially alliances were mostly formed between two partners but since the late 1990’s smaller alliances have emerged into larger. Today there are three large alliances in the
international airline industry; Star Alliance, One World and Sky Team\(^3\). The same airline can be involved in several alliances, both domestic and international (Vaara et al., 2004). Hunnicutt (2004) states that within the airline industry the term alliance has been used on too many cases when the real procedure has only been collaborations i.e. in the sales of tickets. Further he means in opposite to others that only a frequent flyer program does not qualify as a strategic alliance (Hunnicutt, 2004).

Mockler (1999) means that a frequent contractual agreement in the airline industry is code sharing. Code sharing is as a mean for airlines to be able to offer destinations to their passengers that the airline by itself does not serve. This enables an expansion of the airline’s route system without necessarily adding airplanes. By a code sharing agreement the airline markets the other company’s service as their own service and vice versa. In the code sharing agreement there is the possibility to combine frequent-flyer programs and share ticket sales (Mockler, 1999). Koza and Lewin (1998) mention code sharing agreements in the airlines industry as a typical alliance network where the members obtain residual revenues by selling each other’s tickets.

### 2.4 Theoretical Propositions

Here we will use parts of Porter’s five forces model to connect the theories about strategy and strategic alliances with the airline industry. We do this as we believe it to be helpful in describing the competitive state of the airline industry and thus the implications for strategic alliances among low-cost airlines. Further this will provide us with a base and pre-understanding when collecting empirical findings and this was mainly used when forming the interview guide\(^4\).

#### 2.4.1 The Threat of Entry

The threat of entry depends on how easily new actors can enter the industry which is determined by the amount of barriers to entry (Porter, 1980). The airline industry, despite extensive deregulation, still has evident barriers to entry due to regulations. Protectionism towards previously state-owned airlines can inhibit new entry for domestic and foreign actors. The foreign actors can also face barriers in the form of ownership restriction in many countries. In the EU these barriers have diminished, but the European Commission still governs mergers and acquisitions to avoid distorted competition. Further the costs of starting a new airline are extensive and thus these initial costs should also be viewed as a barrier to entry.

A defensive alliance strategy can have as purpose to minimize the financial risk (Spekman et al., 1995). To minimize the initial cost barrier, an airline can be inclined to join a strategic alliance to enter a new industry or market. To avoid the regulation barriers to entry airlines are known to utilize what Spekman et al. (1995) refers to as an offensive alliance strategy. In the EU there is no longer the issue of cabotage

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\(^3\) See appendix 2

\(^4\) See appendix 3
restriction but if an airline wishes to fly their passengers to multiple destinations in for example the USA, they will need an alliance partner to do the connecting domestic flight.

Switching costs are one time costs for the buyer if it chooses to switch from one supplier to another for the same good (Porter, 1980). There are no real switching costs in the airline industry as a passenger can easily switch between airlines without losing money due to the switch. We can on the other hand identify opportunity costs. If a passenger wishes to switch from a large traditional airline where he or she pays a larger fare but receives frequent-flyer points, to a low-cost airline where he or she pays a lower fare but receives no bonus points, the opportunity costs are the lost bonus points at that given time.

For many new low-cost airlines there is a problem to get in to the existing distribution channels. Many traditional airlines operate according to a hub-and-spoke system which in many cases has resulted in dominant positions at large airports. An airline containing a dominant share of the traffic on an airport has a competitive advantage on routes involving that airport (Borenstein, 1989). The low-cost airlines may experience problems as new entrants to acquire lift-off and landing rights at peak-hours.

Product differentiation can pose as a barrier to entry according to Porter (1980). The large established airlines may have a better brand recognition and higher customer loyalty, which forces the new actor entering the market to spend heavily on marketing and promotion to get recognized. Many low-cost airlines are dependent on keeping low costs to enable their low fares which can be contradictory to spending lots of money on marketing.

We can thus propose that if the low-cost airlines face barriers due to regulation or risk they might benefit from engaging in alliances to overcome them. We propose that low-cost airlines can gain from joining together and thus achieve more market power and recognition.

2.4.2 Competitive Rivalry

As Porter (1980) mentions the firms already in an industry are mutually dependent. This is to say that an action taken by one firm to improve their competitive position will generate a retaliation reaction from the competitors in the industry. When the low-cost actors entered the market they had prices below the traditional airlines. The traditional airlines’ initial response was to simply believe that they had differentiated products and thus did not need to lower their prices to stay competitive. Recent years of economic recession after 1999 and tougher competition from low-cost airlines on high peak routes has forced the traditional airlines to lower their fares. This competitive phenomenon in the airline industry can be further explained by Porter’s generic strategies. The generic low-cost airlines are examples of airlines with a cost leadership strategy. Porter (1985) states that to be successful with this strategy the firm needs to find and exploit all ways to obtain cost advantage in that industry. The traditional airlines have been known to have more of a differentiation strategy as they focus on the service attributes to their products and services. Due to the new competition
from low-cost airlines in recent years airlines like SAS and British Airways have been forced to implement substantial cost and savings programs to stay in business.

A way to differentiate an airline is to link multiple markets together through strategic alliances to provide excess service to the customers (Mockler, 1999). If the competitors only have the ability to fly a customer from point A to point B, the airline can gain a competitive advantage by easily offering a connecting flight from point B to point C. This can make the customer choose a specific airline instead that of its competitors’.

We further propose that the retaliation actions taken by traditional airlines to defend their position impacts the low-cost airlines and that linking the markets of low-cost airlines together can be a way to differentiate.

2.4.3 Threat of Substitutes and Bargaining Powers

Any type of passenger transportation that will offer a similar service to that of the airlines is considered a threat of substitute in theory (Porter, 1980). The train or bus industry may be a threat of substitution for the airline industry as they are involved with passenger transportation. The existing research on motives for forming airline alliances do not focus on the threat of bus or train substitution as a reason (cf. Kleymann & Seristö, 2001; Mockler, 1999) and we consider it to be a minor issue for this study and will not go deeper into this.

A motive for traditional airlines to join strategic alliances is the government regulations prohibiting international expansion (Kleymann & Seristö, 2001). There is no previous evidence that the purpose is to gain bargaining power, but rather to avoid a barrier of some sort. We propose that a possible bargaining power incentive for joining a strategic alliance would instead be to join forces as newcomers on the market, against the traditional airlines to minimize those barriers. Like in the case of substitution threats we will treat this as a minor issue.
3 Method

In this chapter there is a presentation of the choice of method to carry out the study. Related to this choice, the method of collecting data is presented and also a list of the data sources used. The chapter follows with the method of analysis and ends with a discussion regarding the validity and trustworthiness.

3.1 Choice of Method

Within methodology the distinction between qualitative and quantitative methods are often made. Quantitative methods are employed when the purpose is to perform numerical measurements. The quantitative method consists of one-way communication and the research is executed solely on the terms of the researcher. The qualitative methods are not used for the purpose of measuring but instead for the purpose of understanding and interpreting (Andersen, 1994). The qualitative and the quantitative method have a main similarity, they both try to bring understanding about our society and its actors and how they affect each other (Holter, 1982, cited in Holme & Solvang, 1991).

The most fundamental difference is that the quantitative method uses the information in form of statistical figures and analyzes this information. In the qualitative method the central purpose is instead the researcher’s thoughts and interpretation (Holter, 1982, cited in Holme and Solvang, 1991). The techniques typically used for qualitative methods are interviews, observations and diary methods. For a quantitative method one would rather use questionnaires and surveys as techniques for collecting data (Easterby-Smith, Thorpe & Lowe, 2002). The main difference is what kind of information one examines and how it is used (Holme & Solvang, 1991).

We have chosen to use a qualitative method as this report aims to do an in-depth study, combining low-cost airlines and strategic alliances. The strive to go deep into a subject is according to Holme and Solvang (1991) one of the characteristics favorable of the qualitative approach, which further brings understanding to the problem studied. To really understand the organization and their situation, one has to come close to it and this is achieved by an in-depth study (Lofland, cited in Holme & Solvang 1991). We believe that by using a qualitative method, based on the above criteria, we will come closer to fulfilling our purpose than by using statistical numbers and techniques.

Holter (1982) states that qualitative research can be imprinted by the researchers and their knowledge and attitude towards the research subject. When conducting the research this can be a strength as well as a weakness as the researcher continuously develops understanding and knowledge. The weakness can lie within the comparing of different information collected from the respondents. A strength is the possibility to pose follow up questions and the ability to be flexible during the interview (cited in Holme and Solvang, 1997). According to Ratner (2002) states there is an issue of subjectivity in qualitative research. This is further supported by Holme and Solvang (1991) who mean that a negative aspect of the qualitative approach is if the conductor
Method

gets too close to the object that it investigates and thereby receives a false image (Holme & Solvang, 1991). Ratner (2002) further states that by having the right instruments and method the researcher can act more objectively.

3.1.1 Case Studies

Case studies can be of different nature, they can be qualitative as well as quantitative. Case studies are not a choice of method, instead you choose an object to be studied (Stake, 1994). Questions that are depth striving, are according to Yin (2003) the preferred questions when conducting a case study, and one of three conditions to consider for a case study approach. The second condition is whether the investigator has control over the behavioral event. A case study is good to use when the conductor has little control over the investigated phenomena, which is the case in this study when we can not control the airline industry. The third condition Yin (2003) mentions is the degree of focus on contemporary against the historical events when it is decided that a how or why question is formed. In our study the topic we treat relates to a contemporary context, it is constantly changing and developing today. Yin’s (2003) suggestion is when the contemporary approach is applied it is useful to do a case study. The case study tries to illustrate one or many decisions regarding how and why they were taken, implemented and what they resulted in (Schramm, 1971, cited in Yin, 2003).

There is certain criticism regarding the use of case studies. Gummesson (2000) points out that case studies can not generate a generalization for other parts. Other criticism is that case studies can contribute to hypothesis generation, but the problem is that these hypotheses can not be tested after they have been generated. For this study, these criticism are not applicable as it does not aim to generalize regarding the airline industry as a whole. Instead it aims to distinguish a phenomenon in our investigated companies that also can be true in other companies in similar situations. We are neither trying to generate a hypothesis nor trying to prove one. This is in line with our choice to use the case study approach, and according to Stake (1994) a characteristic feature of the case study is that it is defined in the interest of the specific case, not as a generalizing method.

3.1.2 Case Selection

Yin (2003) discusses the choice of unit of analysis and mentions that there can be confusion when defining that unit. The researcher should be able to explain why he or she has chosen the specific case or cases and how they can contribute to fulfill the purpose of the study.

The criteria we looked for in our cases to study were that they should be low-cost airlines flying point-to-point and mainly on the Scandinavian market. We contacted four airlines available matching these criteria. Two of these agreed to be part of this study and interviews were made with top level management. At one of the airlines there were two strategically relevant respondents to interview resulting in three interviews total for the case studies. Further we performed an interview with a field expert to get more information about our field of study.
3.2 Interview Methods

According to Easterby-Smith et al. (2002) in-depth interviewing is the most fundamental qualitative method to use. This creates a direct contact with the respondent and this is according to Holme and Solvang (1991) a characteristic feature of a qualitative study. There are positive and negative aspects concerning personal interviews. Personal interviews are relatively fast to conduct and the conductor has the possibility to pose a follow up question immediately if necessary. During a personal interview the researcher can read the respondents gestures and face expressions. This can lead to a more balanced description of the research subject and the conductors can achieve a greater estimation about what knowledge the respondent beholds regarding the subject. A potential downside can be that it is hard to pose questions of sensitive nature when facing a person as the possibility to be anonymous for the respondent does not exist (Eriksson & Wiedersheim-Paul, 1999).

When gathering information there are two important aspects to consider; standardization and degree of structure. Standardization refers to what degree the interviewer is part of the formulation of questions and the order in which they are posed during the interview. The degree of structure is to which degree the respondent can interpret the questions with regards to his or hers own experience and knowledge (Patel & Davidsson, 1994). What type of interview methods that are recommended depending on the degree of standardization and structure are shown in figure 3-1.

![Figure 3-1](image)

Figure 3-1 Different types of interviews or questionnaires depending on the degree of standardization and structure (Patel & Davidsson, 1994, p. 62).

The interviews conducted for this thesis would place our interview method in the bottom right corner with a medium degree of standardization and a low degree of structure. The purpose is to perform qualitative analyses of our results but our interviews were at the same time somewhat structured.

An open interview is most appropriate when the numbers of respondents are relatively few, and when the researchers are particularly interested in what a specific re-
respondent have to say about a given subject. The open interview takes time to prepare and gathers a lot of information to process afterwards which can be a negative aspect if you are doing many of them (Jacobsen, 2002). Our four interviews contributed with a substantial and relevant amount of information about our case study objects and our subject. Therefore there was no reason to perform further interviews with further respondents.

In the beginning of our interviews we posed neutral questions first regarding the respondents’ backgrounds. We also ended each subject by asking if there was anything else that could be added to previous questions or other comments. This technique is supported by Patel & Davidsson (1994). They further states that how the follow up questions should be stated depends on to which degree the interview is structured. As mentioned we use a medium degree of structure in the interviews.

3.3 Data Sources

This thesis is built upon primary and secondary data and our sources are presented in the table 3-1 below. To distinguish between primary and secondary data Patel and Davidsson (1994) state that primary data is for example a first-hand report and a secondary data is then a second-hand report. They further state that it is important to distinguish between these when analyzing verbal documents and the closeness to the respondents is a deciding factor.

Denzin (1989) uses the term data triangulation which refers to the researcher combining data sources to study the same social phenomenon (cited in Johnson & Turner, 2003). The term triangulation is also used in mixed method contexts, when the researcher mixes for example qualitative data with quantitative data (Brewer & Hunter, 1989). The validity when using triangulation and mixed methods can be questioned. Brewer and Hunter (1989) state that if reliable research instruments used in a triangulation generate conflicting results, then the validity of the instruments can be questioned. In this study we use a qualitative methodological approach and we do not mix it with a quantitative approach. We use triangulation when combining several data and information sources regarding the same problem to investigate, the low-cost airlines and strategic alliances.
Table 3-1 Data sources used for this report.

<table>
<thead>
<tr>
<th>Data Source</th>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Press</td>
<td>Secondary</td>
<td>We used articles from the general press and business journals to collect</td>
</tr>
<tr>
<td></td>
<td>Data</td>
<td>current information about the airline industry. Scientific journals were</td>
</tr>
<tr>
<td></td>
<td></td>
<td>used to gather the latest research on strategic alliances and the airline</td>
</tr>
<tr>
<td></td>
<td></td>
<td>industry.</td>
</tr>
<tr>
<td>Public Relations</td>
<td>Secondary</td>
<td>We used company material from airlines and specifically our case study</td>
</tr>
<tr>
<td></td>
<td>Data</td>
<td>objects to learn more about our studied cases. This type of information was</td>
</tr>
<tr>
<td></td>
<td></td>
<td>gathered mostly from our case study objects’ websites.</td>
</tr>
<tr>
<td>Internet sources</td>
<td>Secondary</td>
<td>International aviation organizations and governments provide information</td>
</tr>
<tr>
<td></td>
<td>Data</td>
<td>on their websites that we have taken part of. Information regarding airline</td>
</tr>
<tr>
<td></td>
<td></td>
<td>history, regulations and control are examples of data and information</td>
</tr>
<tr>
<td></td>
<td></td>
<td>collected.</td>
</tr>
<tr>
<td>Top management</td>
<td>Primary</td>
<td>Our interviews are performed with top management and CEOs at the low-cost</td>
</tr>
<tr>
<td>interviews</td>
<td>Data</td>
<td>airlines we have investigated. This thesis aims to investigate strategic</td>
</tr>
<tr>
<td></td>
<td></td>
<td>issues regarding low-cost airlines and therefore we see no need in</td>
</tr>
<tr>
<td></td>
<td></td>
<td>interviewing lower level employees.</td>
</tr>
<tr>
<td>Field expert</td>
<td>Primary</td>
<td>To complement the information gathered from our case studies we have</td>
</tr>
<tr>
<td></td>
<td>Data</td>
<td>interviewed an airline industry expert. This was done to get an outside</td>
</tr>
<tr>
<td></td>
<td></td>
<td>view regarding the airline industry and our case studies.</td>
</tr>
</tbody>
</table>

3.4 Method of Analysis

Pratt (2000) mention different strategies when presenting your empirical material and making the analysis. The researcher can use all, or nearly all, data to provide a rich description of the collected data. The advantage is that the violence to experience is minimized, meaning that the researcher does not translate the informant’s experiences in his or her own way. On the other hand many researchers want their results to be able to generate new theory which require some degree of involvement of structure. Pratt (2000) further proposes the use of quotes to summarize the experiences instead of only using a rich description. To be able to discover the most important information and to categorize the findings to get a structure Strauss (1987) proposes coding as a method. Coding involves discovering and naming the categories of your material but it also has to go deeper and find the underlying information related to the main categories. Strauss (1987) mentions that for case materials there should be a balance between presenting a lot of data and letting it speak for itself, and using the data as evidence to the author’s theoretical argument.

There are different ways to present the data in relation to the theory. Gioia and Chittipeddi (1991) use first- and second-order findings to structure their empirical findings and analysis. The first-order findings describe the dominant themes brought out of the information gathered. The second-order findings put the first-order findings into a wider theoretical structure. By using this structure, the first-order findings can be-
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ter display the respondents’ interpretations regarding the subject. The second-order findings connect these interpretations to theory to look for subjacent explanatory dimensions. The advantage of this structure is that the reader is less likely to mix up the main empirical parts with the theoretical parts. Pratt (2000) mention that by linking the insights gained from the empirical study to existing theory, there is the possibility to overcome the problem of generalizability.

For this report the empirical findings will be presented with the viewpoint of the main subjects arisen from the interviews, that is the first-order findings. The cases are presented one at a time with regards to the main subjects that can be distinguished from the interviews, with an exception for the interview with the field expert. Only a background is presented and the information was further used directly in the analysis to reflect on the two case studies. Since the subjects posed in the interviews were based on the theoretical propositions they are also reflected in the coding process. Further there is a balance between providing a rich description and the use of quotes to strengthen the underlying story being presented. To get the richness from the information gathered we have used long and rich quotes to let the material speak for itself. This process can also be viewed as the first-order findings of this report. Our analysis, the second-order finding, is structured with our frame of reference in mind and the empirical findings of our case studies was compared and analyzed using the theory. From this we drew out the underlying subjacent dimensions to come up with our results presented in the form of our conclusions.

3.5 Validity and Trustworthiness

Johnson and Christensen (2000) state that valid research is plausible, credible, trustworthy and hence defensible (cited in Johnson & Turner, 2003). We will use the term trustworthiness to evaluate our results, which according to Denzin and Lincoln (2000) in turn consists of credibility, transferability, dependability and confirmability. These terms can be compared to internal validity, external validity, reliability and objectivity, used in positivistic and quantitative approach contexts.

Credibility

The credibility should be based upon the extent to which information was gathered and used in a justifiable way. The question one must ask is; did the researchers explicitly account for how the information was collected, have they justified their research strategy, method and analysis, and is there sufficient details so that the conclusions can be evaluated (Denscombe, 2002). For this research we have done a prestudy by reviewing newspaper articles and scientific articles regarding the airline industry and low-cost airlines, to gain an understanding about our research field. This together with the frame of reference gave us the possibility to early on in our interviews pose follow up questions and get a substantial amount of relevant information. Our theoretical presumptions can incline a somewhat subjectivity to our interviews and research. By posing open but specific questions we were able to get a wider answer that did not reflect our own thoughts. According to Holme and Solvang (1991) the researcher often receives less information from the first respondent due to lack of pre-understanding or knowledge about the subject. This is why our pre-understanding
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was important for the interviews. Further credibility is provided since our respondents agreed to let us use their names and hence the reader can easily verify the information with the direct source.

Transferability

Transferability is with regards to the extent one can make generalizations from the research results. There must be sufficient information presented regarding the characteristics of the cases studied, so that one can evaluate to what extent the results can be used or applied more widely. Transferability is much more intuitive when describing what the results might be able to be transferred to as opposed to generalizability that aims to prove and demonstrate (Denscombe, 2002). When doing case studies there is no statistical validity and it is not possible to make generalizations on the basis of them (Hägg and Hedlund, cited in Gummesson, 1988). Since a rather rich description of the case studies is provided the reader can compare the characteristics of the case studies and make the choice whether the findings can be transferable to other similar cases. However, there is not the possibility to generalize regarding our results for all similar cases. Further Pratt (2000) mentions how to overcome the problem of generalizability. One way is to display how your context is similar to other contexts and thereby show that your findings can be applied in those other contexts. Pratt (2000) agrees that qualitative methods are not intended for making generalizations. Instead he stresses that the strength of qualitative methods is their ability to provide deep, realistic insight into a relatively small number of organizations. This study investigates two different cases which is an approved number of cases to use in a case study (Carson, Gilmore, Perry and Gronhaug, 2001). We further strengthen the information gathered from the cases by the interview with a field expert.

Dependability

The use of the term reliability, are we measuring what we intend to measure, is not as useful when doing a qualitative research (Holme & Solvang, 1991). Lincoln and Guba (1985) suggest that the term dependability is used instead. Dependability is more specifically concerned with the process of inquiry and with determining whether it is acceptable or not. In our study we performed an in-depth study to create a deeper understanding of our research subject, the low-cost airlines. Both case studies chosen are typical low-cost airlines but with different backgrounds providing us with possibly confirming or complementary information.

Confirmability

If dependability looks at the process of the study, confirmability focuses on the findings to establish if they are backed up by relevant information and data and thus their ability to be accepted (Lincoln & Guba, 1985). Our frame of reference provided us with information regarding collaboration and strategic alliances. Together with our case studies and field expert we have created a base for confirming the relevance of our findings. Holme and Solvang (1991) also stress the importance of looking at the relevance of the findings. The research relevance regards the utility value of the results which means if the information gained can be a basis for new knowledge (Holme & Solvang, 1991). Since the subject of low-cost airlines combined with strategic alliances
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and collaboration is a phenomenon that is not a widely researched field on the European market, this study aimed to provide further and deeper knowledge specific for this area. Research relevance is also regarding what *comprehension value* our results possess. Will the information we gather be a foundation for creating a deeper knowledge (Holme & Solvang, 1991)? Most of our information was gathered from in-depth interviews with our research objects and a field expert. As mentioned before we used data triangulation by using these three relevant sources of information which would imply good basis for creating new and deeper knowledge. Finally, the research relevance values the ability of the results to create or develop new *theoretical knowledge*, concepts or models (Holme & Solvang, 1991).
Empirical Findings

4 Empirical Findings

This chapter aims to provide the first-order findings of this research. The airlines investigated and the respondents interviewed are presented and important themes and quotes are brought and presented from our collected material. The structure for each case presentation is different due to the difference in material leading to the first-order findings.

4.1 Fly Me

We interviewed Fredrik Skanselid, accountable and operational manager at Fly Me, and Anders Holst, commercial vice president and managing director for the Fly Me group. Fredrik Skanselid has an eleven year background from the airline industry and he started his career as a helicopter pilot. Anders Holst entered the company in June 2004 and he has a background in the travel industry.

4.1.1 Starting Up

Fly Me was founded in 2003 by five people with a history in the airline industry, most of them had previously worked as pilots. When the concept of low-fare airlines was introduced in Europe, with Ryan Air as one of the pioneers and the phenomenon was spreading, they saw an opportunity on the Swedish market and eventually founded Fly Me Sweden AB.

The first step of the start-up process was to formulate a flight manual and obtain the Aircraft Operating Certificate (AOC). Fredrik Skanselid explains how Fly Me had to search for investors and found a partner in the dormant company Array.

“We had a meeting in the fall of 2003 and we appealed to them. They had been looking for something new for a long time, they were a dormant company. Together with the introduction of low-fare airlines and their will to invest in something new and faster, maybe something sexier, they chose to invest in us and Array later became Fly Me Sweden AB.” (Fredrik Skanselid)

A large issue in the start-up process was acquiring the large amount of capital needed. Gaining credibility was another large issue that the founders had to deal with, as an airline just starting up is considered to be an extremely high-risk company.

“A frequently heard comment was: There’s no need for us to change our slot-schedule or gates, these guys will be gone in six months anyway. We even had to give capital warranties when buying erasers.” (Anders Holst)

“We got our flight permit on Friday January 27 in 2004, late in the evening. The tickets were already sold and we started flying on Monday March 1, so it was kind of in the last minute, you might say. Our flight chief refused to leave there before he had the papers in his hand.” (Fredrik Skanselid)

The airline has only been flying for a year but has frequently expanded with new routes and made additional investments.
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“The initial thought was to only fly from Stockholm to Gothenburg for a couple of years and create stability, but we woke up the whole market. Then you have to be there and go for the available positions since they won't be there in a couple of years. Suddenly everybody's low-fare and low cost. SAS is selling tickets for 450, Flynordic has price ceilings etcetera. We came in and shook around in the casserole real good, and then you have to be ready to make a run for it.” (Fredrik Skanselid)

Fly Me is still today relatively small with an airline fleet of four leased aircrafts and with a possibility to utilize another four if needed. The airline has 110 people permanently employed and uses temporary employees from employment services if necessary. Since the start-up Fly Me have performed several new capital stock issues to acquire more capital.

4.1.2 The Business Model

Fly Me does not define themselves as a low-fare airline but simply as an airline. The reason for this is that Fly Me are against the presumptions made by many regarding low-cost airlines. The business idea is to offer simple air travel on high peak routes to prices lower than the traditional airlines. Anders Holst describes the business as:

“Our business is to enter the routes where people travel a lot and at the times when people travel the most. We have said that it’s easier to move the client from gate 36 to 38 at Arlanda by offering them a relevant time table, an excellent flight operation and with a lower price than the traditional airlines.” (Anders Holst)

Fly Me considers its business model to be unique in the airline industry. Fly Me offer many flights when people want to travel and few when the demand from passengers is low. The four airplanes are leased on a three-year basis and they are used at peak hours, morning and afternoon flights and for charter flight on week-ends. In the summer the planes are also used for charter purposes and two of the planes are let out to an airline mostly operating during the summer. This type of agreement also includes letting out pilots and cabin crew. This business model is used in order to get an optimal use of the flight capacity. Due to this model Fly Me is able to let the planes be on the ground during the day when there is no demand for business travel and still get optimal usage of the air fleet. If needed at peak hours Fly Me rents further flight capacity. In this case Fly Me also gets a pilot but uses its own cabin crew. Fly Me has four airplanes to dispose in this matter and only pays for the hours it uses the planes. This together with the other factors in the model enables Fly Me to keep low fixed costs which is imperative.

“Our central business is about offering our travelers who travel a lot, the business travelers, good departures from the large airports, to low prices in Sweden and the near surroundings. To get that model to work at a low-cost we have a model that is about flying for someone else’s account and risk. This way we raise the number of flight hours on our airplanes so that they are relevant” (Anders Holst)

This model has received a lot of critique from flight experts who believe Fly Me has to sell charter in order to survive. Anders Holst explains this with the fact that the
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business model is unknown to many and unusual in the airline industry. He believes there is an overcapacity between Stockholm and Gothenburg during the day, but stresses that Fly Me flies at peak hour when people are willing to pay more. There is an under capacity at peak hour and an over capacity during the day and chooses not to fly at this time. Anders Holst expresses his own surprise to the originality of this business model in the airline industry:

“In the airlines industry, believe it or not, this is totally unique. In all other industries it goes without saying that you have a lot of capacity when people want it and need it and at other times low.” (Anders Holst)

He further explained this phenomenon by the very conservative nature of the airline industry. Traditional airline businesses have to focus on maximizing the utilization of the firm’s fixed costs, and therefore Fly Me wants to fly as much as possible. He also explains it by the deregulation of the airline industry, since earlier it was not possible to rent the capacity needed from foreign airlines and still today the trade-unions at traditional airlines prohibit them from renting capacity. Critique has also come from other regarding the business model and the fact that Fly Me only flies at peak hours:

“Our model is not easy to swallow for customers, competitors and others. We pick the raisins out of the cookie, a model not fit for taking 75% market share. What we do is taking 20-30% in total on the market where we are present and let the others build up an infrastructure. This is why we will always be the bad guys, but we don’t care!” (Anders Holst)

Fly Me does not mind being compared to the traditional airline SAS:

“SAS has lost over seven billion SEK during the last years and if you scrape the surface one can see that 2/3 of that was lost on the Swedish market. SAS lost this in situations when there were no competition. Despite their cost cutting they are still losing customers which is why they would love for us to go out of business soon. Even if that would be the case, new players will always come along. If you have lost a third of your customers you better start doing something to gain them back, not just wish for your competitors to vanish.” (Anders Holst)

4.1.3 Collaboration

Anders Holst explains his view on traditional airline alliances:

“Traditional airlines have for commercial and other reasons wanted to have their flag positioned in several places. They all wanted to have Trans-Atlantic and Asian flights and some of them have been profitable. As the business world developed it was no longer enough to just fly to one place anymore. To be able to fly your customers farther there appeared a need to create alliances between nations. It would have been natural if these alliances developed into pure groups, larger corporations or mergers. The reason for this is primarily that it has been government owned companies and the regulations have prevented mergers, and also trade-union problems since many people become redundant” (Anders Holst)
Anders Holst does not believe in alliances between low-cost airlines in order to fly the clients farther. To fly from point A to B is what enables Fly Me to keep the low costs. To market and sell more complex products involve a lot more costs and just sharing revenues is very complex. Administration, joint booking systems and flight coordination are examples of cost increasing activities involved with alliances along with more complex capital flows.

“There happens a lot of things that raises the price for your customers when you abandon the A to B idea so one has to be sure that it will pay off in the long-run. I believe there is a market for those who stick to the A to B idea.” (Anders Holst)

Anders Holst mentions the possibility to coordinate time tables so that a customer could choose to fly with another airline to another destination but not with a common booking system. With this type of system the passenger risks missing the connecting flight but the possibility exists for this type of collaboration. Anders Holst points out that at this time Fly Me is not considering this possibility for the near future. He does emphasize the type of alliances Fly Me is pursuing:

“We are thinking more about strategic alliances to use our capacity, since that is what our business model is built on. This is so that we can have 25 airplanes when we need to and only two when demand is low. We have found a model that presupposes strategic alliances and collaborations but in totally different ways than one usually imagines for airlines.” (Anders Holst)

Fredrik Skanselid explains the problems and costs involved in connecting the flight. Costs rise by 35-40% because the need to build up a stand-by capacity.

A part of the collaboration to cut costs is with a charter arranger in the Mediterranean. In the summer time Fly Me has less domestic travelers since the business travelers are on vacation and only need to use four aircrafts for those destinations. The charter arranger needs an extra four planes during this time so they rent capacity from Fly Me. In winter time the planes are standing still costing money. By letting the planes be parked at Arlanda instead of somewhere else Fly Me can rent the hours needed to use at peak hour.

“There are other airlines with contra-cyclical businesses, very much in the summer and little during the winter. We can trade flight capacity with each other. They rent from us during the summer and vice versa. This is a good combination as we have a base of our own operation and a network of suppliers we trade with” (Anders Holst)

“It’s this type of collaboration that earlier has been unheard of and it presupposes a certain number of things. That we have something to trade with, that we have the connections and that there’s a trust between these companies. Also that the regulations allow it and that we have an internal structure allowing it. We have to be flexible! We have the fundamental conditions at place to do this but of course it takes time to build up these relationships and collaborations. But I believe we have done it in a short period of time.” (Anders Holst)
Fly Me believe the administrative costs will not be as high for this type of collaborations. This type of collaboration has been going on before but in small scale and has shown to not increase administrative costs too much. Fly Me also have collaboration with Falcon Air, who rebuilds its mail cargo plane to a passenger plane in 25 minutes and flies for Fly Me in the mornings and afternoons domestically in Sweden. Falcon air has also done technical support and maintenance of Fly Me’s own planes. Previously Falcon Air’s planes were just standing still during the day and now they are earning marginal revenues and Fly Me reduces its costs. SAS used to have this type of collaboration on the route to Umeå but had to cancel it due to trade-union protests because SAS was renting capacity and not using its own.

Fly Me are not against renting personnel but stress that it is important to have a core of people in the organizations with key positions spreading its corporate culture. Fly Me have temporarily used an external firm for pilot training. Rented personnel cost 20 to 30 percent more but if the company instead uses permanently employed staff and it is underused Fly Me believes to be better off renting staff. The cyclical nature of the business forces Fly Me to look at different models to keep the right amount of staff all the time. This summer Fly Me is renting personnel to have enough for the charter collaboration.

“...it was conclusive for us that we joined JAR, joint air regulations in Europe. It makes it easier for us to rent flight and staff capacity. It makes everything easier and the rules are European and works cross-over in all countries.” (Fredrik Skanselid)

4.2 Flynordic

In 2003 Finnair acquired the small privately owned airline Nordic Airlink and turned it into Flynordic. Finnair contacted a former employee, Maunu von Lüders, with a long history within the airline industry and airline alliances and offered him to be part of building up the new subsidiary Flynordic as the subsidiary’s president.

4.2.1 Business Model and View of the Market

Today Flynordic is a Scandinavian low-cost airline with eight leased aircraft. Flynordic have 100 people permanently employed and another 100 working directly for them. This amount of personnel is according to Maunu von Lüders small compared to other airlines, especially compared to the traditional airlines:

“We have 200 divided by 8 which give us 25 persons per aircraft. The traditional airlines employ 150 up to 200 persons per aircraft. This results in that for every person we have; the traditional airlines employ 5 to 10. This says a lot about why it’s so much more expensive to fly with traditional airlines and not as expensive to fly with us, since we have reduced all that is unnecessary.” (Maunu von Lüders)

The vision is to create exceptional surplus value for business travelers as well as leisure travelers, by offering a certain degree of service at lower prices. By doing this there is the possibility for more travel and more people get the opportunity to travel.
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“Our intention is to offer the market a reasonable alternative to the traditional airlines that have been present for a long time and not been as customer friendly regarding the costs.” (Maunu von Lüders)

Flynordic explains how it keeps low prices by the following. Flynordic only flies from point A to point B and back, and is not part of costly alliances or global networks. Further there are no lounges, bonus systems or free champagne. Bookings are primarily done through the Internet and e-tickets are used. Finally there is the possibility to get extra service by paying for it and Flynordic further tries to cut down on administration. Maunu von Lüders says that SAS’s new domestic tickets for 450 SEK are not comparable to Flynordic’s prices. He means that these tickets are hard to find since it is only a few percentage of the seats that are at 450 SEK, and the tickets are not very flexible. Maunu von Lüders describes the company as a something between a typical low-cost airline and a traditional airline:

“We do as a typical low-cost airline regarding the cost-image and simplicity, but at the same time are we comparable with the traditional airlines regarding the product... so we are low-cost with a focus on business travel and has complemented it with leisure traveling to European destinations and charter.” (Maunu von Lüders)

Maunu von Lüders further describes why Flynordic tries to position itself between the low-cost and the traditional and stresses the importance of satisfying the customers even if Flynordic are offering low prices:

“We are a service factory, we have aircrafts that must make money, but they have to do money in a way that the customers feel that they receive much more value when buying a service from us.” (Maunu von Lüders)

Regarding the competition in the airline industry Maunu von Lüders explains his view of the overcapacity on some of the high traffic routes:

“Yes, it is obvious that there is a lot of competition and overcapacity on the route between Stockholm and Gothenburg. SAS has said that they blame us for the overcapacity, which is a rather monopolistic way of thinking...Sweden is a free market economy and I think it always will be, and then the market will decide who stands for the overcapacity, not the traditional airlines, that isn’t how it works.” (Maunu von Lüders)

As mentioned earlier Flynordic is owned by Finnair. Maunu von Lüders describes Finnair as one healthy airline with a stable economic base. However this does not mean that if Flynordic does not become profitable Finnair will keep its daughter company.

“Yes, we have a strong owner, but even a strong owner has no reason to keep a rotten egg. It is like a disease or a virus, your whole body can be well, but then you get a nail infection and you don’t feel so good, you have to get rid of it. Finnair’s ambition is that we are a part of their expansion strategy but we have to do it in a way that is reasonable for the owners.” (Maunu von Lüders)
4.2.2 Collaboration

Flynnordic is collaborating with competitors in different ways. Its main collaboration is code sharing with other Nordic airlines: Sterling and Norwegian Air shuttle. Code sharing means switching seats from one plane to another, i.e. Flynnordic can have 50 seats on Sterling’s flight while Sterling then receives 50 seats on Flynnordic’s flight. This switch can be on the same route or on routes to different destinations. Maunu von Lüders stresses the reason for doing this:

“What we get from the collaboration is an economic based thing; we are relatively vulnerable because our margins are based on high load factors. We offer low prices since we believe that we can fill up our airplanes quite well. There is a lot of risk involved in this and if we can share the risk, by not concentrating on a few routes, but rather to spread it on several routes, then it becomes reasonable, and we can do this by collaborating with code sharing arrangement.” (Maunu von Lüders)

The important factor is the risk sharing, if the seats are shared both of the airlines faces a lower risk.

“It is easier for us to be successful in selling fewer seats to two destinations than in selling many to one.” (Maunu von Lüders)

The gain is that Flynnordic also receives more destinations and products to sell. Maunu von Lüders means that this can lead to a more credible product for the customers. Further the additional cost will not be that high. There is a small cost in synchronizing the systems but Maunu von Lüders means that this is all. Compared with the traditional airline alliances in the industry it is a very small cost, since the bonus systems, lounges and distribution systems are extremely costly.

Another issue to regard before commencing collaboration with another firm is its view on service, meaning it is important that both airlines offer the same quality and the same safety standards.

“All the companies that we collaborate with have strict rules regarding safety. We do not want to be involved with someone that doesn’t hold a good quality standard because it affects our standard. The challenge is if our products are not equal.” (Maunu von Lüders)

Maunu von Lüders stresses that this collaboration is not the same as being a part of a big alliance and it is not possible to draw many parallels between a global alliance and a low-cost collaboration. In a global alliance the company wants to make the whole alliance network its own network, but Flynnordic’s intention is not to get a network and transport the customers further to other destinations.

Regarding collaboration by matching departure schedules with other airlines or its own schedule, this is not something that Maunu von Lüders thinks is very important. This is due to the fact that most of the customers only fly from point A to point B. He thinks that the most important issue is to offer a good product that satisfies the customers that flies point-to-point and if it would be synchronized by itself it would be a good thing. If the customer chooses to fly further than point-to-point he or she
does this on their own risk and matches two different products. According to Maunu von Lüders there are also insurance companies offering the possibility to buy an insurance providing the same kind of security that traditional airline alliances offer, if there is a certain time between the arrival and the departure.

Flynordic is also co-operating by selling its capacity to tour operators, to both summer and winter destinations. This is done because Flynordic wants to optimize the use of the flight capacity. On weekends it is not necessary to fly as many domestic flights and Flynordic can use the planes to fly charter instead. Flynordic is selling charter both on long term during the whole summer and at the same time individual flight during week ends.

During regular flights Flynordic is also transporting mail and packages, but only if it is easy and fast to load since the aircraft cannot stand still on the airfield for longer periods due to the high costs. Maunu von Lüders says:

“It is most important for us to get reasonable utilization of our production capacity since the more one flies, the smaller the unit cost will be, which is important in a cost sensitive industry such as the airline industry. To be able to compete with the traditional then we have to be much lower and cheaper seat per kilometer ratio. To be able to do this we have to use our aircraft fleet in an effective and efficient way.” (Maunu von Lüders)

“We are an airline and we can not afford to stand still in the middle of the day. We then have to fly somewhere else and that is to destinations outside of Scandanavia that is attractive and where the schedule is not that important.” (Maunu von Lüders)

Flynordic is using the personnel pool work@ARN that is specialized in the airline industry. Out of the air-hostesses only about 10 are Flynordic’s own and the rest are hired. The positive aspect of hiring air-hostesses is the flexibility. If the demand will decrease Flynordic does not have to fire the staff or relocate them. The partner who Flynordic hires from can instead relocate the personnel easier and has more flexibility. There are also rules by Luftfartstyrelsen regarding the airline industry necessary for Flynordic and its competitors to adjust to. The regulation regarding AOCs makes it hard to have a collaboration regarding personnel because an employee can only fly under a certain AOC and not change the airline they work for if they are not re-educated.

4.3 Presentation of the field expert - Harald Rosén

Harald Rosén started in the airline industry in 1970 and has been part of building up the regional air traffic in Sweden. Further he has been a pilot, flight director and business executive. He was also a part of the air transport authority for eight years. Further he was vice president at Transwede, a new airline created after the deregulation in 1992 and later sold to Braathens. He is now the president of Svenskt Flyg, an organization with the purpose to increase the knowledge about the aviation, promote the development and competitiveness of aviation and the flight sector. The organiz-
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tion monitors the airline industry, hosts a large website and holds seminars regarding the industry.
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The analysis presents the second-order findings where the connection between the first-order findings and the frame of reference is made. The structure is based on the theoretical field presented in the frame of reference.

5.1 Airline Industry Reflections

Our literature review and study of the airline industry states that the airline industry is a conservative and previously heavy regulated industry. Watson (1997) states that “for no rational reason the aviation industry is not game to be like any other industry”, and he was referring to the still much controlled parts of the industry. Anders Holst expresses that “the airline industry is among the most conservative I have faced in my working career” but he follows by saying that this is starting to change due to the deregulation. Maunu von Lüders exemplifies by looking at SAS’s view on the new low-cost airlines; “SAS has said that they blame us for the overcapacity, which is a rather monopolistic thinking...Sweden is a free market economy and I think it always will be this and then the market will decide who stands for the overcapacity, not the traditional airlines, it is not how it works.” Porter (1985) refers to the actors in an industry as being mutually dependant and that an action taken by one actor is likely to induce a retaliation action from the other actors. When Fly Me and Flynordic entered the Swedish domestic market the state of competition was changed. As Fredrik Skanselid expresses; “...we woke up the whole market....Suddenly everybody is low fare and low cost.” SAS has taken actions such as restructuring the booking system and offering certain tickets to a low fare which can be seen as an action of retaliation.

5.1.1 Prerequisites for starting up

Fly Me was started by former pilots and the vice president has worked in the travel industry. This implies that there could be a more unconventional thinking as opposed to the traditional airline strategies and way of doing business. On the other hand Fly Me was faced with specific barriers to entry due to the fact of being a new entrant on the market. Porter (1980) mentions the access to distribution channels as possible barriers to entry and Fly Me has exemplified this in its difficulty to obtain slots and access to gates at the large airports during the start-up.

The owner of Flynordic is Finnair, a traditional airline, and the president has a background in the traditional airline industry and strategic airline alliances. This can be seen reflected in the choice of strategy and its premises for doing business. Flynordic has strong capital owners supplying capital, but it is not unconditional as Flynordic explains; “Finnair’s ambition is that we are a part of their expansion strategy but we have to do it in a way that is reasonable for the owners” (Maunu von Lüders). Flynordic’s start-up was facilitated by strong and established owners as well as the fact that it was started through an acquisition of a smaller existing airline.

The fact that Flynordic has a strong owner supplying capital can imply that it is more likely to survive in an increasingly competitive environment. Harald Rosén
confirms that this is a significant difference between Fly Me and Flynordic. He further emphasizes the fact that Fly Me started from scratch with little previous airline experience. Harald Rosén states that the ambitions of the airlines are similar, to make money and become profitable, but they differ in ownership structure and the owners intention. To exemplify, Harald Rosén further implies that Finnair uses Flynordic to put pressure on SAS. If this implication holds it can question if Flynordic is really more likely to survive in the long run. Manu von Lüders clearly points out that even though Flynordic has a strong owner in Finnair, Flynordic is not operating in certainty and that Finnair is not likely to keep a non-profitable subsidiary in the long run.

5.2 The Low-Cost Airline Strategy

Porter (1985) mentions three generic strategies that can be used to gain competitive advantage; cost leadership, differentiation and focus. Airlines such as Fly Me and Flynordic have been called-low cost, low-fare, no frills airlines and the name might seem unimportant, but in fact it can imply what type of strategy is being used. Often the term low-fare airline is used, but it might be misleading regarding the strategy used. Harald Rosén expresses his concerns regarding the name; “Low-fare is a dangerous word, is it an airlines that sells tickets for 450 crowns? Or is it an airline selling almost all their tickets to a low fare?... let’s say you’re leaving tonight and you go down to Skavsta airport and buy yourself a ticket to London and then it costs 2500 crowns instead of 250, then is that still low-fare? No, you should call it low-cost airlines or no frills airlines.”

5.2.1 Fly Me

If we see Fly Me as a low-cost airline flying point-to-point, it would be following a cost leadership strategy. In order to be successful in doing so part of the strategy has to be concerned with finding and exploiting all possible ways to obtain cost advantage. Fly Me can also be seen to have a cost leadership focus strategy. The main business is to fly in the mornings and afternoons focusing on the business travel segment. Fly Me calls this the dog-bone strategy where it is focusing on the large ends of the bone and leave others to work on the small middle. Fly Me also refers to this as “picking the raisins out of the cookie” (Anders Holst). So this cost leadership focus strategy means Fly Me has to find ways to be cost efficient. This is where collaboration and flexibility to be able to find new ways of cutting costs become important. In the ways to achieve low costs it is important to have a wider scope and operate in the charter industry which implies a less focused strategy and more of a generic cost leadership. Porter (1985) describes a typical low-cost producer as a company offering a standard or no-frills product and tries to get economies of scale and cost advantages where possible. The flight capacity alliance and charter arrangements are examples of cost cutting activities to enable low prices on Fly Me’s core activity.

Porter (1985) mentions the risks of completely losing focus on differentiation. To succeed with the cost leadership strategy the product or service has to be comparable to those of the competitors. If it is not comparable to a certain standard the company will be forced to lower the prices much lower than competitors to gain any sales
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which is not the purpose of the low-cost strategy. Fly Me needs to be aware of the risks Porter (1985) mentions regarding focusing too much on becoming the cost leader and not having a comparable product. According to Harald Rosén the low-cost airlines do not have the same possibility to offer economies of scale and scope advantages as the big traditional airlines as SAS. Harald Rosén mentions this as one of the reasons why the cheap prices that low-cost airlines are not selected and that the customer rather chooses to fly with SAS instead. “There is a large-scale production, you get economies of scale by being large and known” (Harald Rosén) With SAS the customers can, even if they cancel one flight, take the next one that will probably leave in within a short timeframe.

5.2.2 Flynordic

Flynordic is also a low-cost airline flying point-to-point but does not have the same focus as Fly Me. It has an even wider scope in its ways to become the cost leader. Flynordic also has a main focus on business travel domestically but in the process of cutting costs expanded the number of destinations to include destinations in Europe focusing on leisure travel. Further a lot of emphasis is put on creating a service that measure up to those of the competitors. Maunu von Lüders describes Flynordic’s view; “We do as a typical low-cost airline regarding the cost image and the simplicity, at the same time we are comparable to the traditional airlines regarding the product...”. The danger according to Porter (1985) in this approach is the balance between the amount of differentiation and at the same time focus on being the cost leader. On the other hand, if Flynordic succeed in becoming cost leader with a somewhat differentiated product it is likely to obtain large competitive advantages.

Harald Rosén states that there is a risk concerning the charter arrangements that the low-cost airlines engage in during the summer. They arrange contracts from June to October which is a longer period of time than the time that business travelers are on vacation. There is a danger in this since both airlines are taking their regular planes away from the domestic business travel and thus cutting down on their departures. This gives the competitors the opportunity to steal market share during this time. Harald Rosén further questions if the airlines will be able to regain these customers in October, when the airplanes return. We believe that both airlines are diverging from their strategy, which is focusing on the business travelers. Fly Me clearly states “Our main business is to offer our frequent travelers, the business travelers, good departures from the main airports to low prices, within Sweden and regions nearby.” (Anders Holst). This is a clear indication of a situation where the pursuit to become cost-leader gets in the way of what is claimed to be the main business.

5.3 Collaboration for competitiveness

We earlier defined strategic alliances as “a close, long-term, mutually, beneficial agreement between two or more partners in which resources, knowledge, and capabilities are shared with the objective of enhancing the competitive position of each partner.” (Spekman et al., 1995 p. 4). Further Shiva (1997) distinguishes between horizontal and ver-
tical alliances where horizontal refer to collaboration with competitors and vertical to value chain integration.

5.3.1 Alliance Configuration

In the case of Fly Me we can identify vertical collaboration that can be viewed as strategic alliances. Fly Me has a network of suppliers with whom the flight capacity is traded. It is clear that these alliances are mutually beneficial agreements creating value and advantages for all the partners involved. Regarding the collaboration with Falcon Air, the mail cargo airline, Fly Me gets access to more flight capacity during the days as Falcon Air only flies during the nights. This leads to lower fixed costs as only the flight hours utilized are paid for. At the same time Falcon Air can benefit from the agreement as it get marginal revenues. The intention for the collaboration between Fly Me and Falcon Air is on a long-term basis and there is an exchange of knowledge and capabilities. This is shown in the fact that Falcon Air also does technical support and maintenance on Fly Me’s own aircrafts. Contractor and Lorange (2002) would define this as vertical quasi integration collaboration as the partners are contributing with complementary benefits. Falcon Air reduces its excess flight capacity and Fly Me reduces its costs.

Fly Me also collaborates with charter arrangers that have contra-cyclical businesses to its own. In this case there is also a clear mutually beneficial agreement as the charter arrangers get access to more capacity during the summer season in Europe when it normally has a shortage of it. During the summer Fly Me can let out part of its own aircraft fleet since the demand for the domestic flight operations is lower. According to Fly Me’s strategy to be cost leader on the market these types of cost cutting alliances are in line with strengthening its competitive position. In this collaboration the trade is being performed with similar inputs and outputs, that of the flight capacity. Contractor and Lorange (2002) mention that firms with comparative advantages can receive cost advantages by using each other’s comparative advantages. In the case of Fly Me and the charter arrangers there is a trade of the same resource and there is also the comparative advantage of supplying excess capacity when the other partner needs it.

Flynordic has both vertical and horizontal alliances. The vertical alliance is similar to Fly Me’s collaboration with charter arrangers in the summer and winter time that can be both on a long- and short-term basis. The code sharing agreements Flynordic has with Sterling and Norwegian Air Shuttle are horizontal collaborations due to that they are all competitors in the same business. This is a clear close, long-term and mutually beneficial agreement. The partners’ competitive position is strengthened in many ways through costs and economies of scale and scope. By selling each others tickets they gain economies of scale and economies of scope as they are able to offer more destinations. This is supported by Flynordic stating “It is easier for us to be successful by selling fewer seats to two destinations than to sell many to one.” (Maunu von Lüders). The fact that each respective airline sells the tickets as if they were their own can be confusing for the customers. If a loyal customer of Flynordic buys a code shared ticket to a destination that is handled by another airline there can arise confu-
sion. The airline might be unknown to the customer and then there can be feelings of uncertainty. Thus it becomes important to choose the right partners for collaboration which will be discussed further down in this section.

5.3.2 Alliance benefits

As Kleymann and Seristö (2001) argues, an airline can choose to join an airline alliance for two main reasons; efficiency-seeking and market-oriented. Efficiency-seeking benefits can arise from joint resource utilization and examples are economies of density and increased load factor on the flights. The market-oriented benefits can be related to strengthening the market position or adding value to the product (Kleymann & Seristö, 2001; Spekman et al., 1995). In traditional airline alliances this is done by offering the customer a link to the world market by joint ticket sales, central hubs and connecting flights. To learn from alliance partners are also a category of benefits derived from airline alliances. Koza and Levin (1998) had a similar classification of alliance objectives and used the terms exploration or exploitation strategies.

Both Fly Me and Flynordic are using collaboration to achieve efficiency benefits which implies exploitation strategies. An overall impression from the airlines is that they continuously and all through the organization strive to cut costs and seek efficiency. Kleymann and Seristö (2001) further divide the efficiency-seeking benefits into labor productivity, aircraft productivity and benefits derived from lower procurement costs. Compared to traditional airlines low-cost airlines have different activities and sources of efficiency.

Fly Me achieves aircraft productivity by a number of ways and activities. Fly Me only has its own aircraft fleet of four leased planes and for further capacity are rented in the form of hourly aircraft capacity when needed. This keeps the fixed costs lower and to fully utilize the own capacity Fly Me let out the capacity of its own aircrafts when possible. Fly Me explains this with “We are more thinking about strategic alliances to use our capacity since this is what our business model is built on. This is so that we can have 25 airplanes when we need to and only two when demand is low.” (Anders Holst).

Flynordic tries to achieve aircraft productivity with its own eight leased planes with another approach. The code sharing arrangement with Sterling and Norwegian Air Shuttle enables Flynordic to increase the load factor when flying and to gain economies of density. By increasing the number of destinations in Europe during the day besides the domestic business travel Flynordic can maximize the utilization of the aircrafts. Flynordic stresses the importance this activity; “We’re an airline and we can’t afford to stand still in the middle of the day. Then we have to fly somewhere else and to destinations outside of Scandinavia who are attractive and for which the timetable isn’t as important” (Manu von Lüders). The advantage for Flynordic with the code sharing agreement is the possibility to add value and extra destinations for the customers and at the same time gain aircraft productivity. Fly Me on the other hand does not have to fly to extra destinations to get aircraft productivity to the same extent as Flynordic, since it only has four own aircrafts on which to minimize the fixed costs.
Kleymann and Seristö (2001) mention labor costs as the largest source of potential cost reduction. Both Fly Me and Flynordic try to lower these costs by renting in personnel when possible. The difference is that Flynordic rents in most of the cabin crew while Fly Me believe it is important to keep a core of its own personnel who spreads and contributes to the company culture. By not having its own cabin crew the airline can lose the ability to control the service quality and the spreading of its corporate culture. It is possible to see this as a delicate balance between keeping a high service quality and low costs. Despite this, there are advantages of renting labor. When the demand for business is low there is the advantage of not having to pay for staff not being used. On the other hand rented staff is generally more expensive than using the own personnel. However in the long-run it is likely to reduce the costs by having rented personnel if the business is cyclical. Fly Me has acknowledged this problem and therefore makes sure to utilize its personnel as much as possible. An example of this is letting out flight capacity and personnel to charter companies in the summer.

5.3.3 Alliance Costs and Risks

There are several risks involved in close collaboration. Spekman et al. (1995) stress that the company needs to be aware of the costs involved in collaboration and weigh these against the benefits derived from it. The partners need to be compatible and have common goals if they are to succeed. This can be connected to the risks of letting out the flight capacity for four months during the summer. The charter company has as main goal to get enough capacity for its needs. The airlines are looking to maximize the use of its aircrafts. If the airlines do not agree to let out flight capacity for the full four months there is a chance that they do not get the contract at all.

When choosing the right partner it is important that the companies are compatible concerning values and cultural aspects (Spekman et al., 1995). If another airline will be flying the customers it is important to make sure it is done according to certain safety and service standards. Flynordic has its code sharing agreements where the customers buy a ticket on the home page but it is another airline doing the actual flight. The risk here can be if the other airline does not satisfy the customer this may reflect badly on Flynordic. When Flynordic started the collaboration with Norwegian Air Shuttle, Norwegian Air Shuttle did not keep the same service standard on board the flight. Flynordic’s customers were offered simple food and beverages which was not the case on Norwegian Air Shuttle flights. On the specific code shared flights Flynordic set the demand that there would be the same service standard on board, so Norwegian changed its routines for these specific flights.

Davies (2001) says that companies collaborating must share information and learn from each other. The downside to this is the risk that the collaborating partner is a competitor and might use the information to its own advantage. In the Flynordic case a strictly code sharing agreement is used where Flynordic buys a certain amount of flight seats and sell as its own. No profit sharing or larger information as well as technology sharing has to take place which minimizes that risk.
5.4 Traditional Strategic Airline Alliances

Mockler (1999) explains why the phenomenon of airline alliances is common in the airline industry. He claims that this is due to increased customer demand for international traveling, government regulations and ownership and the hub-and-spoke structure of airline routes. There are also the issues of the high capital investments required and the way to promote and sell tickets that make airlines form alliances.

The typical low-cost airline only flies from point A to point B and no further. If the passengers of these airlines have the demand to fly further than point B, this would imply that the low-cost airline needs to engage in strategic alliances to satisfy that need. However there is no evidence of this kind of alliances in the low-cost airline industry today. The respondents from our cases clearly stated their views on this issue. The whole idea with a low-cost airline is keeping low costs, keeping it simple and thereby offering low prices. From both our case study objects the main resistance towards alliances was the cost issue. Fly Me expresses this with “There happens a lot of things that raises the price for your customers when you abandon the A to B idea so one has to be sure that it will pay off in the long-run.” (Anders Holst). The low-cost airlines do not use a hub-and-spoke system and clearly has no objective to link their routes to any other system. Fly Me further explains this by the large administrative costs involved with strategic alliances. Having a common booking system and sharing revenues increase the complexity and the costs considerably. According to Mockler (1999) this is a reason for the traditional airlines to join in an alliance but our respondents claim it as a reason against. To have a system where flights are connected there has to be a stand-by capacity which increases the costs by up to 40%. If there is no stand-by capacity there might be substantial costs for compensating the passengers for missing a connecting flight.

Flynordic has a similar approach to traditional airline alliances and on its home page it is explained how Flynordic can keep low costs partly by stating “we are not part of any costly alliances or global networks”. The research made by Vaara et al. (2004) suggests that small- and medium-sized airlines who engages in strategic alliances experiences disadvantages and claims it to be time consuming, and a small airline does not have the time or money for it. These are similar disadvantages as the respondents propose.

The traditional airlines used strategic alliances to avoid the impediment of government regulations. This is supported by Fly Me who explains the traditional airline alliances; “The reason for this is primarily that is has been government owned companies
Analysis

...and the regulations have prevented mergers...” (Anders Holst). Due to the deregulation and the new conditions on the European market today there is no direct need for low-cost airlines to use alliances to enter a new market or to perform mergers and acquisitions. If a low-cost airline wishes to acquire another airline there is nothing stopping them in terms of regulations since it is not a large player on the market. This is supported by the field expert, Harald Rosén, who claims that it will be years before any of these airlines will be in a position where they are large enough to have to ask for permission to perform a merger. He sees this as an advantage for the new actors, that they are free to enter new markets or to do mergers.

The reasons and motives for traditional airlines to join in strategic alliances differ form those of the low-cost airlines. The low-cost airline motives for alliances are mainly efficiency and low cost seeking. By sticking to the A to B idea the airlines are concurring with the strategic intent of being the cost leader on the market. The respondents were asked regarding the possibility to match the time tables with other airlines so that the customer could book a ticket themselves to get from point B to C. Fly Me are not strange to this type of collaboration in the future but are strongly against a common booking system due to the increased costs involved. Flynordic states that if the time tables would be matched by themselves that would be positive but he sticks with the idea to only fly point-to-point and satisfy those customers.
Conclusions and Final Discussion

Based on our analysis we will here point out what we have concluded concerning our research questions and our purpose. The chapter ends with a final discussion that includes the subjects this thesis has touched upon but not gone deeper into, as they were not directly connected to the purpose but still interesting.

6.1 Conclusions

We identify that the strategy of our investigated low-cost airlines is to be cost efficient and through that offer low prices. This implies that they should engage in collaborations and alliances that help to follow this strategy. We also identify several collaborations that can be viewed as strategic alliances due to the mutually beneficial nature and long-term objective. These collaborations are horizontal as well as vertical and their common features are that they mainly aim to reduce cost and achieve efficiency regarding aircraft productivity. The horizontal code sharing alliances provide the airline with additional benefits from an enlarged product range in the form of a larger number of destinations offered.

The low-cost alliance configuration concurs with the traditional alliance configuration in some areas, such as the horizontal code sharing arrangements. The benefits derived from the alliances are also similar such as market related benefits and resource utilization benefits. The difference lies within the scope and main focus of the alliance. In the case of low-cost alliances the main focus is on resource utilization, while market or product differentiation is a secondary focus. The scope of the alliance and the amount of integration differs as the low-cost airlines, although involved with code-sharing, does not compromise the low-cost side to the collaboration.

The main possible source of problems for the low-cost airlines is balancing low-cost and efficiency seeking with maintaining quality and safety. A low price can be attractive but we find it important to maintain a sufficient level of quality and service. Both airlines studied compromise the service and quality of their main product, domestic business travel, when collaborating with charter arrangers to cut costs. The collaboration stretches over the whole summer which can result in loss of customers when engaging in these collaborations for a too long period. The demand is not likely to be as low for the whole period as the reduction in flight capacity.

Traditionally airlines have engaged in strategic alliances with the purpose of reaching a wider geographical scope, to differentiate the products and services by using each other’s hub-and-spoke systems and to avoid government regulations. These low cost airlines’ main focus is keeping low complexity, being cost efficient and engage in point-to-point flying. Hence there is no alliance motive for internationalization, their main focus is not product differentiation and government regulations are proven to no longer be an issue.
6.2 Final Discussion

As mentioned in our analysis, labor costs are a large source of possible cost reductions. The airlines are already aware of this and to some degree they are working with rented staff to cut down fixed personnel cost and obtain flexibility. This area could further be researched to explore the possible benefits and drawbacks as well as to find new ways to resolve this issue. Previous research shows that rented staff might not experience the same feelings of loyalty towards the employer and this might affect the service quality. It would be interesting to see if this holds for the airline industry.

The airlines we investigated are both new entrants in a conservative airline industry. Despite this the airlines have faced different barriers when entering the market. Flynordic was backed up by a strong owner in Finnair that acquired a small privately owned airline to start things up. FlyMe started a new airline from scratch and met a lot of resistance from established institutions. It is interesting to investigate whether the ownership structure and attitude of the existing players in the industry can influence the success of an airline.

A way for the low-cost airlines to obtain a balance between being a low-cost provider and add value to their products and services is to match time-tables with other point-to-point airlines as well as their own routes. Since the low-cost airlines are reluctant to engage in collaborations increasing their costs this type of time-table coordination must be carefully evaluated. It is interesting to see if this collaboration could be carried out in a simple way and if the benefits derived will exceed the costs involved. There are insurance companies today offering compensation in case of a missed flight when connecting between two point-to-point airline flights. This enables the point-to-point airlines to have a simple collaboration with low risks involved.
References


References


References


Appendix

Appendix 1

Low-cost actors

Low-cost airlines, source Pressens Mediaservice (PM), 2005-02-01.
http://www.ad.se.bibl.proxy.hj.se/index.php?serv=startpage

Outbound from Sweden:

Air Baltic – www.airbaltic.com
Fly Me – www.flyme.se
Flynordic – www.flynordic.com
Germania Express – www.gexx.com
Germanwings – www.germanwings.com
Hapag-Lloyd – www.hlx.com
Malmö Aviation– www.malmoaviation.se
Norwegian Air Shuttle- www.norweigian.no
Ryan Air – www.ryanair.com
Skyways – www.skyways.se
Snowflake – www.flysnowflake.se
Sterling – www.sterlingticket.com
Transavia – www.transavia.com
Wizz air – www.wizzair.com

Other low-cost airlines in Europe:

Air Berlin – www.airberlin.com
BmiBaby – wwwbmibaby.com
Maersk Air – www.maersk-air.com
MyTravelLite - www.mytravellite.com
Flybe – www.flybe.com
Sky Europe – www.skyeurope.com
Virgin Express – www.virgin-express.com
Appendix 2

Major strategic alliances in the airline industry worldwide.

Lead airlines are marked with *.

**Star Alliance partners:**

<table>
<thead>
<tr>
<th>*Lufthansa</th>
<th>Thai Airways</th>
<th>Austrian Group (Austrian Airlines, Tyrolean Airways, Lauda Air)</th>
</tr>
</thead>
<tbody>
<tr>
<td>*United Airlines</td>
<td>Singapore Airlines</td>
<td></td>
</tr>
<tr>
<td>Air Canada/Canadian</td>
<td>Air New Zealand</td>
<td></td>
</tr>
<tr>
<td>All Nippon Airways</td>
<td>VARIG Brasil</td>
<td>British Midland</td>
</tr>
<tr>
<td>Ansett Australia</td>
<td>SAS</td>
<td></td>
</tr>
</tbody>
</table>

**One World partners:**

| *British Airways | LanChile | Cathay Pacific |
| *American Airlines | Aer Lingus | Finnair |
| Iberia | Qantas |  |

**Sky Team partners:**

| *KLM | Malaysian Air System | Alitalia |
| *Northwest | *Air France | Korean Airlines |
| Continental Airlines | *Delta Airlines | CSA |
Appendix 3

Interview guide

We start with a presentation of ourselves and our thesis topic:

We start by a presentation of ourselves and introduce our topic. We further explain why we have chosen the respondents how we will use the material gathered. Followed by this we let the respondent ask questions they might have or express concerns before we start the interview.

The respondents were allowed to talk freely regarding our subject. If needed we asked for their view regarding the pointed out topics presented below.

Subject 1: The Company

- The respondent is asked about himself and his background within the company
- Background of the company and its current position
- Look at the future
- When subject one is treated the respondent is asked if he would like to add something else regarding the subject.

Subject 2: The airline industry

- The position of the low-cost airlines on the market today
- The price situation
- Sweden and European market
- Look at the future
- When subject one is treated the respondent is asked if he would like to add something else regarding the subject.

Subject 3: Strategic alliances and collaboration

- Strategic alliances as a phenomenon in the airline industry
- The low-cost airline view on traditional airline alliances
- Identify areas where collaboration are possible
- Cooperation across nations
- Horizontal competitor collaboration

When subject one is treated the respondent is asked if he would like to add something else regarding the subject.