Bachelor's Thesis

Airline Consolidation in Europe

Small European Airlines' Chances of Survival Amid Industry Consolidation, and the Proactive M&A Auction as a Strategic Way Forward

ZHAW

Zurich University of Applied Sciences

School of Management and Law

International Management

David L. Egli

Matriculation Number: 15540339

Talwiesentrasse 22, 8404 Winterthur

eglidav1@students.zhaw.ch

Submitted to Dr. Markus Braun

Winterthur, 24 May 2018

Management Summary

The European airline industry is experiencing a trend towards consolidation, and many carriers are contesting in a highly competitive environment. From 2011 – 2015, the number of scheduled airlines operating within Europe declined by over 70, and the growing influence of large players such as the Lufthansa Group or the IAG Holding challenges small airlines in their economic viability. Consequently, small firms must find new strategic solutions to secure their continuing existence.

The aim of this study was to clarify the chances of survival for small airlines, and if selling the company proactively through an M&A auction could be a beneficial solution to the consolidation trend. Therein, the focus lies in maximizing the transaction price and ensuring the continuity of the brand. Additionally, the study intended to identify key criteria and stumbling blocks for small airlines considering to follow such a strategy.

To facilitate the understanding of airline consolidation, this study introduced the differences between the US and the European markets. Literature review and expert interviews were used to conduct a trend and market analysis. To reveal key strengths, the collected data also served in the evaluation of other strategic tools such as the SWOT and value chain analysis.

The trend analysis concluded that consolidation will pick up speed and scope, yet in contrast to the US, European airline groups follow multi-branding strategies due to market fragmentation. The pursuit of higher cost-efficiency may lead to future mega-mergers in Europe. Hence, the chances of survival for small airlines were rated as low. The market analysis outlined that the power of buyers as well as the industry rivalry inhibit a small airline's capacity to compete on price. Furthermore, their key value chain factors to safe costs were identified in Human Resources, Logistics, and Marketing and Sales. This was congruent with the findings in the SWOT, which discovered the lower salaries and the operational flexibility to be the main strength of small airlines. The thesis showed that takeover pressures are inevitable, but proactivity can positively impact on the transaction price, since there is no immediate need to sell. Merger success factors were found in the *Strategic Niche*, the *Organizational fit* such as the availability of planes, and the alignment of the airline *Staff* to maintain the aforementioned cost advantage.

Concluding, the study suggested that key criteria for the auction to yield a positive outcome are proactivity, prudent market foresight, the leverage of success factors, and a clean operational history. Conversely, the misalignment of staff, the inability to make concessions, the lack of a raison d'être, and the perceived desperation by the buyer could be major stumbling blocks. By extension, this means the key criteria and their impact should be carefully studied within the organization, and resources should be assigned as to their efficient management. Last, wider research into the development of a framework for such airline auctions is recommended in order to guide executives in building a business case.

I. Table of Contents

II. List of Tables

III. List of Figures

IV. Abbreviations

A/N	Author's Note
ACMI	Aircraft, Crew, Maintenance, and Insurance
AOC	Air Operator Certificate
ASK	Available Seat Kilometers
BA	British Airways
CCO	Chief Commercial Officer
DACH	Germany (D), Austria (A), Switzerland (CH), the region where all three countries border on
EASA	European Aviation Safety Agency
EBIT	Earnings Before Interest and Tax
EFTA	European Free Trade Association
EU	European Union
F&B	Food and Beverage
IAG	International Airlines Group
IATA	International Air Transport Association
ICT	Information and Communication Technology
LCC	Low Cost Carrier
M&A	Mergers and Acquisitions
OAG	Official Airline Guide
P&L	Profit & Loss
RPK	Revenue Passenger Kilometers
US	United States

V. Glossary

Aircraft, Crew, Maintenance, Insurance (ACMI)	A wet-lease option in which the operator sells the tickets and brands the flight, but hires the rest from a second operator. This operator provides everything else to fly the route, including the aircraft and crew. (Swoboda, 2016)
Airport Slot	Gives an airline the right to operate from and to an airport at a given time; usually used if the number of takeoffs and landings at an airport are restricted due to certain constraints, such as the number of parking spaces or limited opening hours. Airport slots can be acquired or traded and can be extremely valuable (Eurocontrol, 2016).
Available Seat Kilometers (ASK)	Method to measure flight passenger capacity; the number of available seats on scheduled flights multiplied by the number of kilometers they are flown (AirlineGeeks.com, 2015)
Buy-on-Board	A service concept in which the passenger can purchase additional services on board such as food and drinks
Charter	A type of non-scheduled air service (Eurocontrol, 2005, p. 39)
Commercial Air Flight	An air transport flight performed for the transport of passengers and/or freight and mail, for remuneration or for hire (Eurocontrol, 2005, p. 16).
Commercial Air Service	An air transport flight or series of flights for the public transport of passengers and/or freight and mail, for remuneration or for hire (Eurocontrol, 2005, p. 16).
Goodwill	Arises when a company pays a premium on the value of the company it acquires. Goodwill is shown in the the purchased company's asset side of the balance sheet.
Large Carrier / Airline	For the purpose of this thesis, any airline with a fleet size of more than 200 aircraft, or more than 40m carried passengers per annum
Legacy / Network Carrier	Refers to the traditional airline carriers (what used to be the 'national' airlines) that operate an extensive

	global route network, in contrast to the new business model of Low-Cost Carriers
Long-Haul	Traffic flow, for which every airport-to-airport distance is more than to 4000 km (Eurocontrol, 2005, p. 13).
Medium Carrier / Airline	Any airline with a fleet size of more than 50 aircraft, or less than 40m carried passengers per annum
Medium-Haul	Traffic flow, for which every airport-to-airport distance is more than 1500 km and less than or equal to 4000 km (Eurocontrol, 2005, p. 13).
Non-scheduled air service	A commercial air service other than scheduled air service (Eurocontrol, 2005, p. 16).
Revenue Passenger Kilometers (RPK)	Method to measure demand for air travel by calculating the kilometers flown by paying passengers; obtained by multiplying the number of revenue passengers by the kilometers flown (AirlineGeeks.com, 2016)
Scheduled air service (scheduled airline)	A commercial air service operated according to a published timetable, or with such a regular frequency that it constitutes an easily recognizable systematic series of flights (Eurocontrol, 2005, p. 16).
Short-Haul	Traffic flow, for which every airport-to-airport distance is less than or equal to 1500 km (Eurocontrol, 2005, p. 13).
Small Carrier / Airline	Airlines with a fleet of less than 50 aircraft, or less than 5m carried passengers per annum
Vertical Range (of Manufacturing)	The degree of how deep a firms knows the special market or segment that it particularly takes care of (Trestl, Appendix 11.1.2)

1 Introduction

1.1 Introduction to the topic

The focus of this thesis is the consolidation in the European airline industry, especially concerning small carriers competing against the growing influence of large players. In the US for example, mega-mergers and industry wide consolidation have brought 10 major airlines down to just four big ones – in a time span of only 12 years (Yellin, n.d.). Though the American and European markets differ (as outlined under section 2), Robertson (2017) reports that similar consolidation trends are to be expected in Europe, and are even welcomed. The recent events of the Air Berlin bankruptcy, as well as the struggles of Alitalia and just lately Air France (Bryan & Lawson, 2018) are growing signs of how the pressure for cost reduction and synergy creation drives consolidation.

1.2 Research problem

Consolidation trends in the airline industry suggest that at some point in the future, many small carriers may be confronted with mergers and acquisitions (M&A) pressures from large players. Recent events in Europe (Alitalia, Air Berlin, Monarch, and Air France) also indicate that buyers are reluctant to purchase grounded airlines in one piece but rather cherry-pick the parts most suitable to them i.e. tear the companies apart (Enz, 2018). Overcapacity has increased the reduction of air ticket fares (King, 2017). Confronted with these pressures, the question arises how small airlines should respond, and what their chances of survival are in this consolidation-driven environment. Thus, the research question is: to survive in one piece, could it be beneficial for small sized airline carriers to prepare themselves to be sold on their own terms? And to succeed in such negotiations, what is crucial in this process and what are the buyer's areas of interest to make him buy the entire airline? To answer this question, the stumbling blocks and key success factors possibly imperative in the process of preparation are also examined.

1.3 Knowledge gap

Current research provides extensive information about airline consolidation, the M&A-mechanics, and the respective industry trends. Quantitative as well as qualitative industry analyses are easily accessible. However, specific information about how small airlines may prepare themselves to be sold and what the respective success criteria might look like is missing. Rather, only general information about success factors in M&A transactions are available. This thesis aims to close this gap by providing research in this field and presenting possible and specific implications of such airline transactions.

1.4 Research objective

The findings of this study should support the understanding of the nature of the consolidation trend in Europe and provide a basis for further research. To exemplify some cases, focus is put on the Swiss market and the respective players. However, results should, to some degree, be generally valid for small airlines. The aim is to lay the grounds for developing a framework small airlines may follow in order to set themselves up for an auction process. Instead of going bankrupt and then being divided piece by piece, such a framework may help small airlines find a way to co-exist amongst large industry players without being swallowed by them, while losing their brand and corporate identity completely (as has been the case in many US Airline mergers).

1.5 Viewpoint and aim

When referring to the small airline in general, the respective parties targeted in this thesis are the executive management and major shareholders. In the most favorable case, their intentions are aligned, and this thesis assumes that their goal is to:

1. Ensure the continuation of business operations under their own brand and protect the interests of the company stakeholders (such as its employees) and,
2. in case of a transaction, maximize the generated revenue for the shareholders

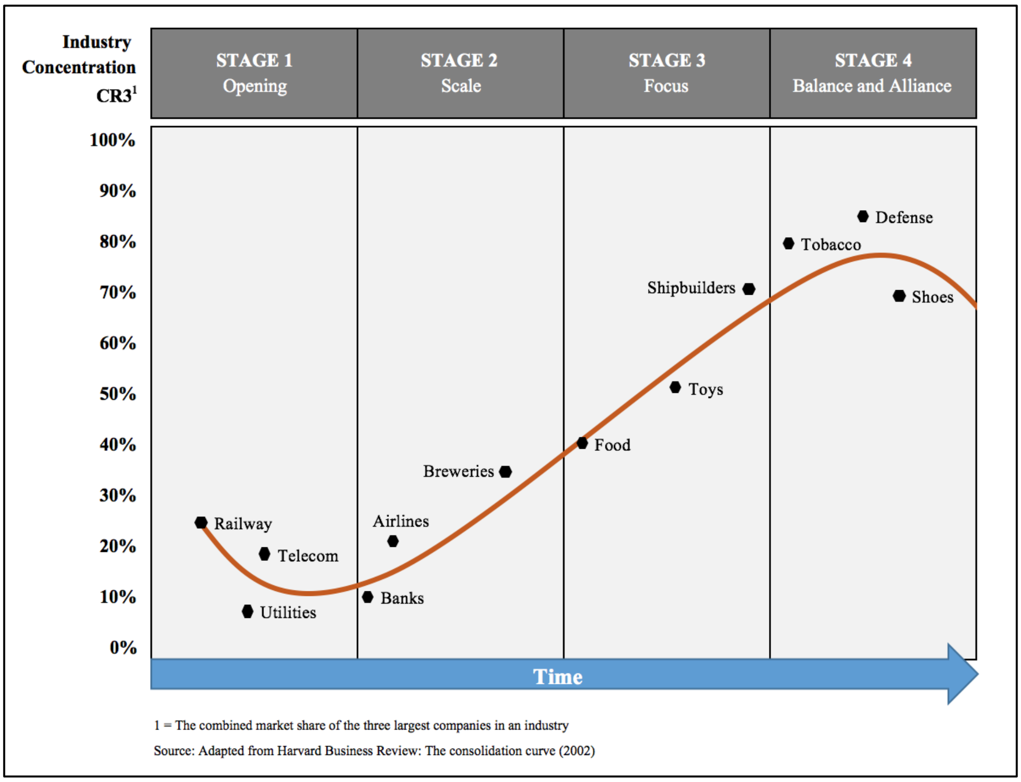
The following section will introduce the nature and roots of aviation market consolidation and outline the differences between the highly consolidated American airline industry and the European aviation sector.

2 Introduction to airline market consolidation

This section introduces the dynamics behind market consolidation. Thereafter, it presents the current state of consolidation in both the American and European markets. Lastly, it gives an overview of the Swiss market and the respective airlines.

The definition for consolidation used for this thesis is the process of combining two entities (companies) into a single firm (Kocic, 2017). This consolidation can take different forms and can be executed using different strategic options, such as mergers and acquisitions (M&A). The form and intensity varies according to industry type and the respective players competing in the business environment. Christensen (2016) explains that industries go through three stages of consolidation (Fragmentation, Acquisition, Expansion), with each stage having its own dynamics and offering opportunities for companies to expand.

Figure 1 The consolidation curve (own illustration, adapted from Deans et al., 2002)



Deans, Kroeger, & Zeisel (2002) went a step further and developed a simple model of the industry consolidation life cycle called the '*consolidation curve*' as seen in

Figure 1. In their model, Deans et al. (2002) show that industries go through four stages, namely Opening (stage 1), Scale (stage 2), Focus (stage 3), and finally, Balance and Alliance (stage 4). According to the authors of the model, the consolidation life cycle is usually kicked off by the formation or deregulation of an industry. Moreover, companies can, to some degree of accuracy, map their position in the cycle (Deans et al., 2002).

As presented in Figure 1, industries move in an S-curve through the different stages, with industry concentration (i.e. combined market share of top three players) first dropping before consolidation starts to continuously increase it again. The stages can be summarized as follows:

1. Opening

The new industry forms or is deregulated, and combined market share of the three largest players quickly drops to between 10 and 30 percent. This stage features fierce competition, new entrants, and start-ups. Deans et al. (2002) state that during stage 1, companies should focus on revenue rather than profit, and aim for increased market share.

2. Scale

Stage two is about building scale, and as consolidation sets in rapidly, large players emerge and buy up smaller firms. Deans et al. (2002) conclude that in stage two, the top three players will hold combined market share of 15 – 45 percent. The authors also mention that airlines are typically found in this stage. They further suggest that companies in stage two should direct resources towards their M&A skills, learn how to preserve their core cultures and competitive advantage, and develop models for quick integration of acquired targets.

3. Focus

The consolidation frenzy of stage two leaves the top three players in stage three holding between 35 and 70 percent market share. According to Deans et al. (2002), businesses continue to aggressively outgrow competition, and stage three features a series of mega-deals as the goal is to emerge as the undisputed industry leader. Emphasis should be put on core capabilities and profitability, quick response to start-up competitors, and the identification of other players that are likely to survive into the final stage.

4. Balance and Alliance

As seen in Figure 1, stage four is dominated by the giants that survived all other stages – the top three players now claim around 70 – 90 percent market share. Firms stay in this stage, and now have to defend their position. This can be done by forming alliances, or finding new ways to grow the core business (Deans et al., 2002).

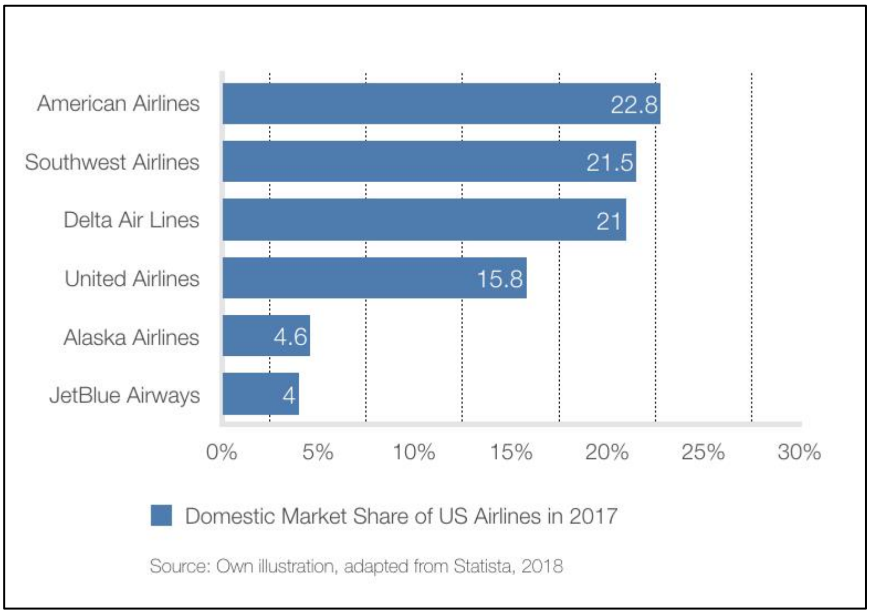
Deans et al. (2002) conclude that it is imperative for companies to manage their ability to react quickly, and success depends on how well a firm can "ride up the consolidation curve". Ultimately, slow and weak players are going to become acquisition targets and disappear somewhere in stage 2 or 3 (Deans et al., 2002).

The consolidation curve and the respective stages are an important source to understand the nature of market consolidation within the airline industry. Specifically, it enables the plotting of the industry within the cycle, and helps to show how consolidation differs from one market to another (in this case the American and European airline markets).

2.1 American market

As proposed by Deans et al. (2002), consolidation in the US market started with its deregulation in 1978. Quickly, new entries followed, and fierce pricing competition set in (Kort, 2017). According to Hethcock (2017) there were over 400 certified airlines operating in 1978. As the industry progressed to stage two of the consolidation life cycle, M&A activity increased dramatically, and some 160 carriers filed for bankruptcy in the four decades that followed. As elaborated above, Deans et al. (2002) mention that airlines are typically to be found in stage two on the consolidation curve. The US Airline industry, however, further progressed and the past decade saw some mega-mergers typical for stage three – reducing the number of mid and large sized carriers from 18 to just 10 by 2017 (Hethcock, 2017). Or, to put it differently, from the 11 largest airlines in 2004, measured by revenue, five have vanished (Mutzabaugh, 2015).

Figure 2 Domestic market share of US Airlines in 2017 (Statista, 2018)



The mega-mergers of the past decade further consolidated the top end of the industry players, leaving the US domestic market with four major airlines (also referred to as 'the final four') – American, United, Delta, and Southwest (Kort, 2017). The 'Focus' stage in the consolidation life cycle features the top three industry players holding 35 – 70 percent market share (Deans et al., 2002). As seen in Figure 2, American, United, Delta and Southwest actually hold a combined market share of over 80 percent – even if leaving out the smallest of them (United), the top three still account for 65 percent.

One may conclude that the US airline market has already advanced to stage 3 in the consolidation life cycle. Arguably one could also say that with consolidation slowing down, the industry is progressing towards stage 4. However, experts and analysts are in disagreement about whether the US market will see another mega-merger. Patterson (2015) sees further mergers as unlikely, especially due to their riskiness and questionable efficiency gains. One may also doubt the approval of a merger within the final four by American federal authorities. On the contrary, experts such as Hammond (2016) argue that, especially amongst the middle-sized carriers, M&A activity is still probable. Unnikrishnan (2016) reports that, according to a study by PwC, further consolidation could lead to a fifth large carrier, reducing the market share gap held by the big four.

Finally, it is noteworthy to point out how consolidation has affected the profitability of US airlines. In the early 2000s, economic downturn and high oil prices put pressure on airlines – the total losses of US carriers summing up to over $40bn in the period of 2001 – 2005 (Assaf & Josiassen, 2012). Consequently, companies sought efficiency gains. The consolidated North American air carriers have thus largely profited from optimized cost structures and synergies and therefore posit larger net profits than their European counterparts (Powley, 2017). In figures, this means the net profits of US Airlines in 2017 of $15.6bn exceeded the European figure ($9.8bn) by almost $6bn (IATA, 2017b). EBIT margins (in % of revenues) of US Airlines in 2017 amounted to an average of 13.2%, while the Europeans' was less than half – 6.3% (IATA, 2017a).

2.1.1 Introduction to Virgin America case

Virgin America is a small airline founded in 2007 by Richard Branson, operating mainly domestic US flights (it also serves routes to Mexico). After receiving takeover offers in early 2016, the airline decided to reach out to potential buyers within the market (Shen, 2016). This process of 'entertaining bids' is of particular interest for this thesis, as it shows how a small airline decided to sell itself on its own terms, rather than being taken over by hostile competitors.

After receiving different offers, Virgin America was sold to Alaska Air (beating competitor Jet Blue in the bid) for $2.6bn (Hackett, 2016). Even though Richard Branson was not able to stop the sale, he still concluded: "Consolidation is a trend that sadly cannot be stopped" (Branson, 2016). In other words: merge or disappear. This sort of 'radical' view is in line with the observations made about the American market in the previous section.

Ironically, Brandon had originally founded Virgin America as a 'counter measure' to decreasing service quality within the US airline industry as more and more airlines consolidated (Hackett, 2016). Kort (2017) confirms this trend, elaborating on how massive consolidation has led to fewer choices for consumers, higher prices, and less quality. Interestingly, Virgin America's share price spiked up 80 percent in the month after it had announced the entertainment of bids in March 2016 (Hackett, 2016). Following the successful acquisition, Alaska Air first indicated to keep the Virgin brand (Calder, 2017). However, as later announced, after April 24th, 2018 the Virgin brand will disappear as Alaska Air decided to completely integrate the acquired airline into the

Alaska fleet – making Virgin America yet another victim of the very consolidation it tried to defy (Genter, 2017).

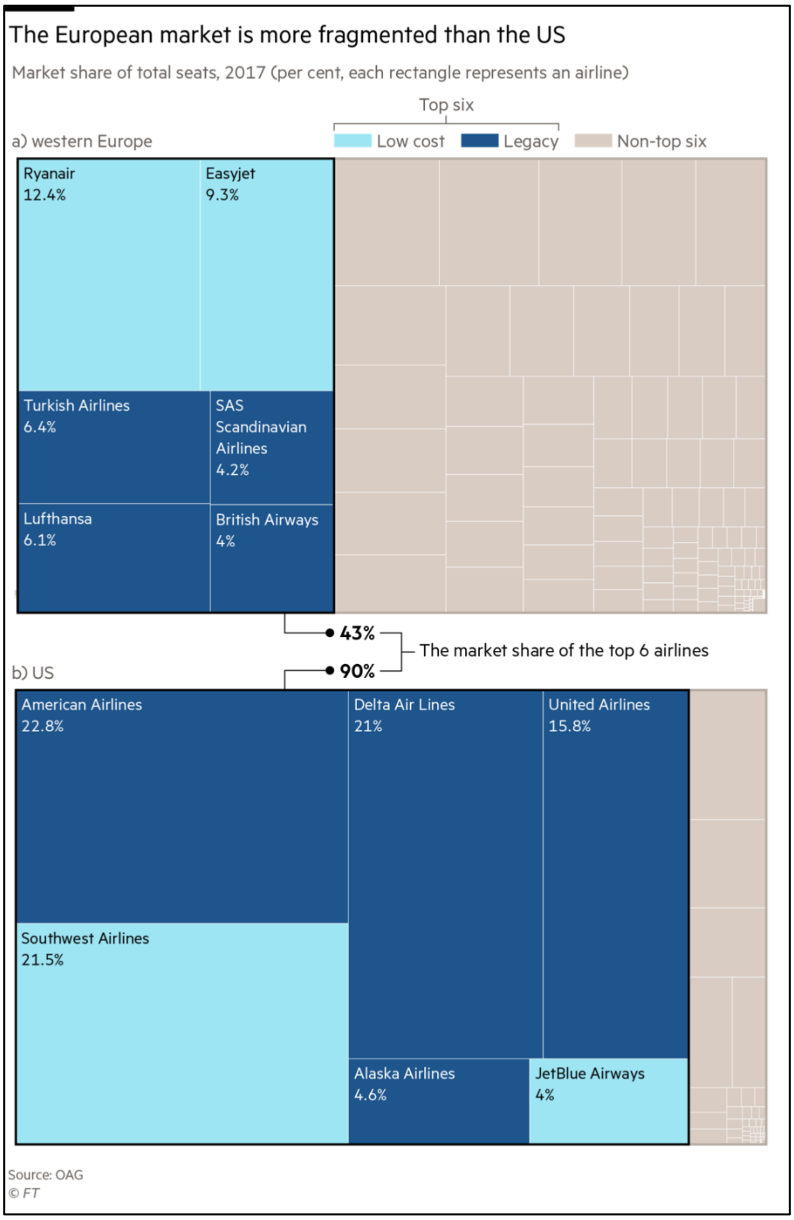
2.2 European market

As seen before in the case of the American market, the consolidation life cycle in Europe was also initiated by market liberalization, which occurred in three stages between 1987 and 1997 (Dobruszkes, 2009). Especially the third stage from 1993 to 1997 brought about almost 'complete freedom' for community airlines. Until 1987 for example, it was impossible for a German airline to operate flights between two French cities. The EU (including EFTA states) liberalized these constraints almost without restrictions (Dobruszkes, 2009). (Burghouwt & de Wit, 2015) thus also stress how the liberalized EU air traffic market has led to increased competition and new business models as airlines needed to react to the suddenly open market form.

Consolidation in Europe, however, differs from the one in the US. Instead of large M&A transactions, airlines in Europe tend to grow more organically, inheriting the parts from airlines that eventually go bankrupt (Powley, 2017). Unlike in the US, where the big airlines have eaten up all the small ones, Europe still features over 100 different air carriers (Powley, 2017)(OAG, 2015).

Dobruszkes (2009) describes competition in Europe as twofold. First, he touts competition between legacy and low cost carriers as "merciless and unrelenting". Secondly, he suggests that there is a more 'prudent' competition between the legacy carriers and their traditional routes. Chapter 6 will look into competitive forces in more detail – as described in the model of Deans et al. (2002), stage two (Scale) in the consolidation life cycle is all about beating the competition to build up size. Prominent examples of this trend in Europe are the emerging large players: Ryanair, Lufthansa Group, IAG (with British Airways/Iberia), Easy Jet, and Air France-KLM (O' Dwyer, 2018). In turn, most prominent and recent 'victims' of the consolidation cycle in Europe are Air Berlin, Monarch, and Alitalia.

Figure 3 European Market Fragmentation (Powley, 2017)



Depending on the measurement method, and whether one takes individual airlines or the emerging Airline 'groups' as a basis, market share of the largest players in Europe differs slightly. Counting the *four* largest *individual* airlines (Ryanair, EasyJet, Turkish Airlines, and Lufthansa), it adds up to about 34 percent as seen in Figure 3 (Powley, 2017). Counting the four major Airline *groups* (which control several airlines) Ryanair, Lufthansa, Air France-KLM, and IAG, they account for about 40 percent (O' Dwyer, 2018). As seen in Figure 3, this is in stark contrast to market share controlled by the 'final four' in the American market.

Concluding, one could say that Europe finds itself in stage 2 on the consolidation curve. According to Deans et al. (2002), the three largest players in this stage of the cycle hold between 15 and 45 percent market share. As seen in Figure 3, Ryanair, EasyJet, and Turkish Airlines control 28 percent of the market. This figure has, however, to be looked at with caution, as the rising airline groups control large portions themselves. Analysts (e.g. (Robertson, 2017) (O' Dwyer, 2018)(King, 2017) (Dichter, Hahn, & Maxwell, 2016) however, all agree that Europe has yet to see more consolidation, and may even witness some mega-mergers in the future.

2.2.1 Swiss market

The Swiss Civil Aviation carried roughly 51.9m passengers in 2016, and contributed around CHF 33.5bn (or 5.6%) to the Swiss GDP (Aerosuisse, 2017). The uncontested domestic market leader is SWISS International Airlines (LX), offering 79 percent of all available seat kilometers (ASK), including Edelweiss flights (WK). The two smallest airlines, Helvetic and Skywork, offer only 0.6 percent and 0.3 percent of ASK respectively (Böck, 2015, p. 48). Böck further concludes that many small Swiss airlines have disproportionally grown their ASK in recent years, and that traffic increase is above average (2015, p. 56).

According to Aerosuisse, eight airline operators were registered in 2017, down from nine in 2016 (Aerosuisse, 2017). The number of commercial operators[1] has decreased from 169 in 2002 (Aerosuisse, 2005) to 62 in 2016 (Aerosuisse, 2017). Some small airlines in Switzerland have also been struggling to survive, most recent example being Darwin Airline (based in Lugano). After fighting an intense competition war against SWISS, the airline was sold by investors in July 2017, and is now owned by the same German investment company that owns Adria Airways (Eiselin, 2017). Darwin Airlines has lost its license to operate after filing for bankruptcy in November 2017 (Enz, 2017).

The case of Darwin shows that the consolidation forces are also at play in Switzerland. With SWISS belonging to the Lufthansa Group, small independent airlines in Switzerland fight for market share and will have to strategically innovate to survive in the future.

---

[1] incl. charter airlines

2.2.2 Players in the Swiss market

Table 1 below gives a short overview of the Swiss scheduled airlines used as examples in this thesis. All but SWISS can be categorized as small. SWISS and Edelweiss both belong to the Lufthansa Group, whereas the other three are not owned by any larger airline or airline group.

Table 1 Airlines in Switzerland (own illustration, Appendix 11.3)

Airline	Homebase	Fleet size	Passengers p.a. (2017)	Category
SWISS*	Zurich	83	17m	Mid-sized
Edelweiss	Zurich	15	1.7m	small
Helvetic Airways	Zurich	12	2m	small
Skywork	Berne	6	156k	small
People's Air Group	St. Gallen Altenrhein	2	100k	Small

*incl. both Swiss International and Swiss Global Air Lines Ltd.

This chapter has identified the nature of consolidation in the aviation sector, and has shown that the European industry is in another stage on the consolidation curve. This starting position is important as it builds the basis for the trend analysis in chapter 5.

Chapter 3 will introduce the concept of the auction process in M&A transactions and its underlying mechanism, before Chapter 4 will outline the methodology used to answer the research question.

3 Introduction to the M&A auction process

The M&A auction is a procedure in which several different vendees opt to purchase a target. The seller collects and evaluates the bids according to their attractiveness, namely the most favorable price and the best conditions (Chen, 2016).

Of fundamental importance in the auction process is to select the amount and type of buyers that are invited to hand in a quotation. Thus the scope of the bidding process is determined by the seller and its strategic and financial intentions (Chen, 2016). According to (Nead, n.d.) there are three different approaches to an auction – the broad auction, the limited auction, and the targeted solicitation. The strategies differ in terms valuation, confidentiality, transaction speed, targeted buyers, and market size. While the broad auction aims at the most favorable valuation through exposure to as many interested parties as possible, the targeted solicitation addresses only a few strategic buyers in a faster and more confidential process. The limited auction then is to be found in the middle of the two previous examples (Nead, n.d.).

The auction procedure typically involves several rounds and confidentiality agreements as well as a prepared room for due diligence (Chen, 2016).

What type of auction the seller choses depends on his or her intentions and whether the aim is to maximize transaction revenue or realize other strategic goals. For this thesis however, it is simply important to understand the concept of auctions rather than what type is chosen by a specific airline. In any case, this would be a management decision and specifically depend on the situational circumstances.

4 Methodology

This chapter introduces the different methodological concepts that will be applied to answer the research question. It starts with the trend and market analysis and the different strategic tools used therein. More so, it describes in detail the major research method used, namely the expert interviews.

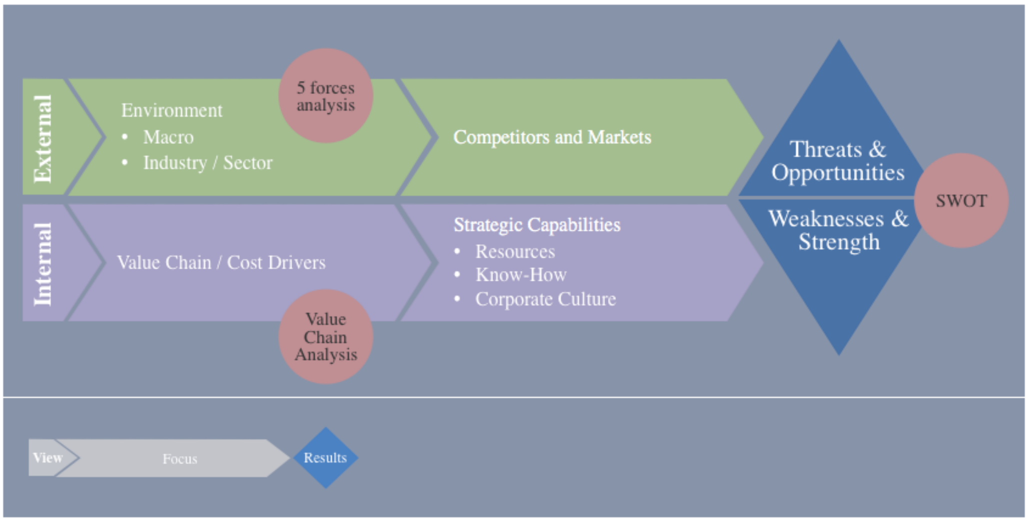
4.1 Industry trend analysis

The industry trend analysis is conducted by reviewing the most recent events in European aviation, the industry results, and what future outlook is expected by different scholars or experts. This review sheds light on where the European market is headed and provides important indicators for strategic positioning of small airlines. Moreover, it addresses the chances of survival for small airlines.

4.2 Market analysis

A market analysis of the European airline market builds the foundation for this thesis. Understanding the dynamics at work, and the specifics of market interactions is crucial in order to comprehend and evaluate how small airlines may perform in this market. Furthermore, the segmentation of the European market brings along key challenges for airlines.

Figure 4 Elements of Strategic Analysis (own illustration adapted from Björk, 2017, p. 7)



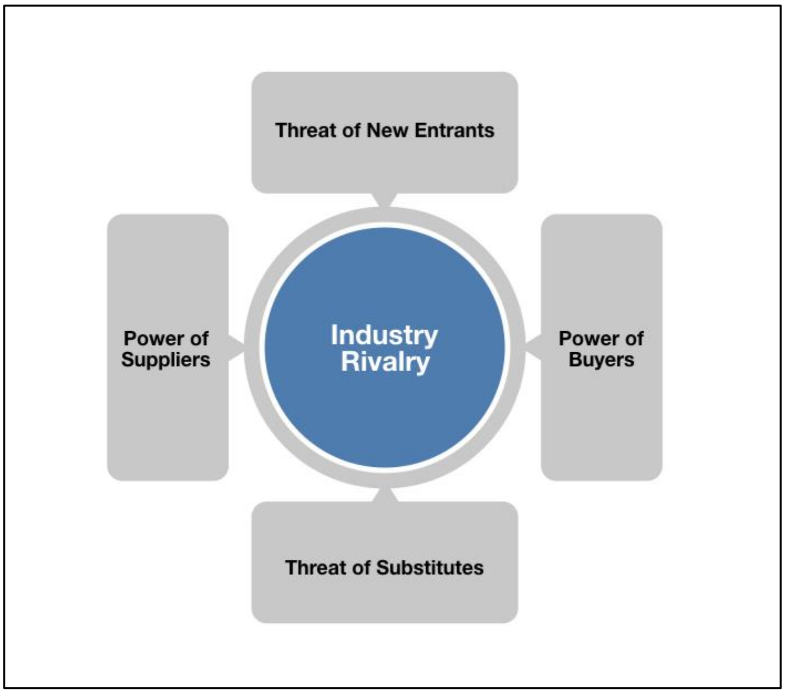
The market analysis will therefore provide the necessary basics upon which this thesis derives other factors within the strategic analysis. To follow a step-down approach, the respective tools used are Porter’s 5 forces model, Porter’s Value Chain and the SWOT-analysis as shown in Figure 4.

4.2.1 Porter’s five forces

Michael’s E. Porter’s model of the 5 forces constitutes somewhat a benchmark when it comes to competition analysis, having been at the center of any management agenda since its publication in 1980 (Kort, 2017). The model is a tool to evaluate strategic options and positions of a given firm within a given industry. In his model, Porter (2008) elaborates on how an industry is influenced by the five forces, and how these shape the profitability of that particular industry. Typically, Porter claims high competitive forces such as in the airline industry lead to low margins and low profitability. Conversely, if competition is absent or benign, firms operate very profitably.

Porter (1998) outlines the five forces as follows: (1) threat of new entrants, (2) bargaining power of buyers, (3) bargaining power of suppliers, (4) threat of substitute products or services, and (5) the rivalry amongst existing competitors.

Figure 5 Porter’s 5 forces (own illustration based on Porter, 1998)



Porter (2008, p 26) states that:

> Understanding the competitive forces, and their underlying causes, reveals the roots of an industry's current profitability while providing a framework for anticipating and influencing competition (and profitability) over time. A healthy industry structure should be as much a competitive concern to strategists as their company's own position. Understanding industry structure is also essential to effective strategic positioning.

Grundy (2006) elaborates on some of the weaknesses of Porter's model. Amongst others, he criticizes the model's mindset of looking at industries as closed entities. Furthermore, the often highly sophisticated industry value chains are broken down and displayed to the strategist in an oversimplified manner. Especially the latter gives reason to the author of this thesis to also briefly look at the industry value chain of airlines (as outlined under 4.2.2).

Thus, analyzing the five forces of an industry gives a comprehensive overview of what and who is influencing the profitability of that industry. The knowledge of key forces can then be transformed into strategic actions (Porter, 2008).

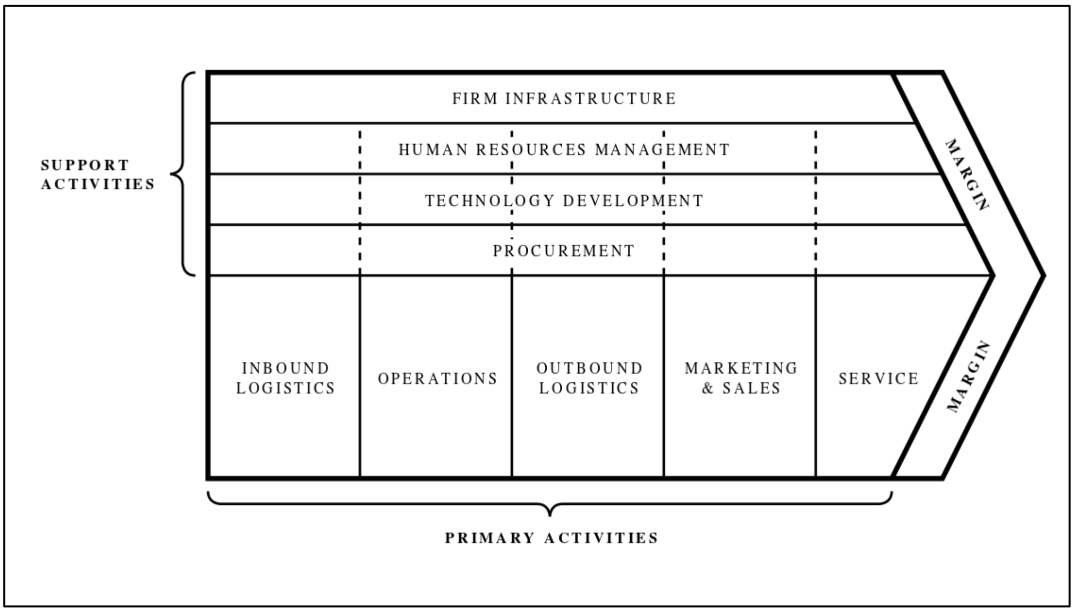
The five forces model is of particular importance for this thesis. Considering the intensity of rivalry in the airline industry and how these forces have been fueling consolidation, analyzing the main drivers and strength of these pressures is vital. A small airline must understand its position, and to what degree it might be able to gain some leverage in a bidding process by reacting to the five forces ahead of time.

4.2.2 Porter's value chain

The value chain is a critical part of any organization because it determines how the company creates value. It inherently ascertains the value creating activities and costs of creating said value. This impacts profitability, as one can assume that the more value a firm creates, the more profitable it is going to be (MindTools, n.d.). Or simply put, if the value created exceeds the costs of performing the respective activities within the value chain, the company operates profitably (Porter & Millar, 1985).

For any organization it is imperative to understand how value is created and where in the value chain the company may save resources. Porter (1985) investigated how firms can gain competitive advantage, analyzing critical elements in their value chain. He identified a chain of 9 elements, split them into 'primary' and 'support' activities and divided them as shown in Figure 6.

Figure 6 The generic value chain (Porter, 1985, p. 37)



The primary activities (Inbound logistics, Operations, Outbound logistics, Marketing and sales, Service) are those relevant for the actual production of the product, selling it to customers and supporting the client after the sale. The support activities (Firm infrastructure, Human Resource Management, Technology development, Procurement) are crucial in catering the needed resources for the primary activities to take place (Porter, 1985). Porter & Millar (1985) further explain that all these activities are connected through 'linkages' and that the effective management of these linkages can identify trade-offs between and across organizational lines. The optimization of trade-offs can therefore be an important source of competitive advantage because it is hard for competition to identify where a firm improves its value chain.

The concept of the value chain is also evolving; the revolution of information technology (ICT) affects all activities in the chain, and creates new linkages and interrelations (Porter et al, 1985). Thus, using new systems and concepts (i.e. big data), companies can now manage their chains more effectively and integrate suppliers and customers more actively. ICT also allows organizations to span activities across geographic locations and interact/cooperate with other players. This role of ICT is crucial in creating new synergies and identifying cost saving trade-offs (Porter et al, 1985).

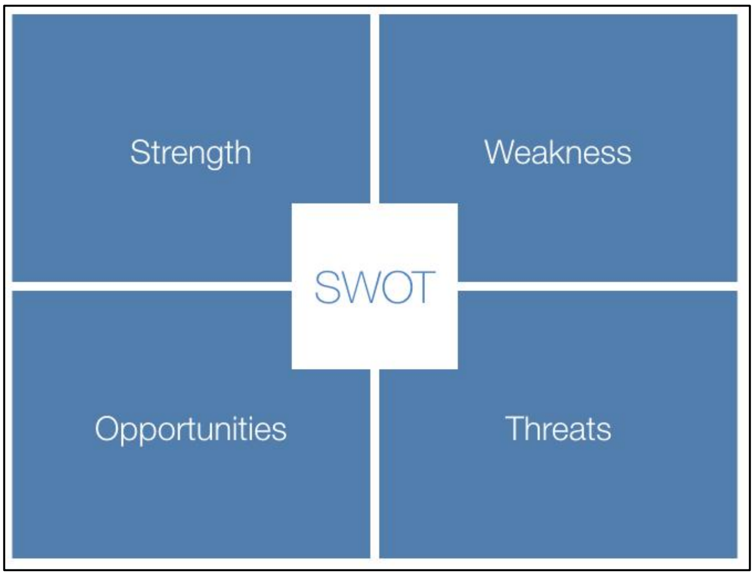
The value chain activities of airlines are rarely isolated and often depend on the functionality of the respective activities of other players (Yılmaz & Bititci, 2006). It is therefore considered to be imperative to analyze the value chain of airlines, what advantages small airlines possess, and how they can align their activities to be easily integrated in the buyer's system.

4.2.3 SWOT

The SWOT analysis as depicted in Figure 7 is a strategic tool to determine an organization's Strengths, Weaknesses, Opportunities, and Threats. In the context of decision making it helps managers to evaluate internal and external factors that may contribute to the firm's success or causes of failure. The SWOT analysis ensures the consideration of all relevant components to the business organization, positive or negative (Ifediora, Idoko, & Nzekwe, 2014). The underlying aim is to identify critical elements and use the knowledge to leverage internal and external strengths and opportunities, whilst monitoring and minimizing weaknesses and threats. Morris (2005, as cited in Bell & Rochford, 2016) concludes that the SWOT follows a circular logic; one cannot know what factor might be a strength or weakness without knowing the environmental circumstances, and vice versa. This fact underlines the importance of the SWOT analysis.

Bell & Rochford (2016, p 310) also report that in recent times, the SWOT has developed into a mere 'set of checklists'. Likewise, Pickton & Wright (1998) warn of the dangers of using SWOT as a simple listing device. Hence, they suggest the use of scoring models or other valuation forms to improve the validity of identified SWOT-factors. The gathered information in the SWOT analysis can then be used to evaluate strategic options and determine how to respond to certain events, circumstances, or trends. The framework channels activities into where the firms core competences lie, and ensures the strengthening of said competences (Ifediora et al., 2014).

Figure 7 SWOT Analysis (own illustration)



The SWOT analysis thus is important for this thesis as it provides any given firm with core information of the four framework areas. The SWOT is crucial because it lists critical success factors of a firm and outlines focus areas to which the firm should direct its resources. The SWOT analysis will draw from information gained in the previous analyses of Porter's 5 forces and Porter's value chain, thus outlining the external and internal factors that are of particular importance for small airlines in Europe.

4.3 Merger success factors

Mergers fail more often than they succeed – different researchers produce different failure rates, but summarized, the relative number can be believed to lie somewhere between 50% and 85% (Heffernan, 2012). Thus, it is imperative to understand what differentiates the successful mergers from the unsuccessful ones if a merger becomes a strategic option for the future. To comprehend the factors that lead to success and derive important aspects for airlines, this thesis uses the dimensions identified by Marks & Mirvis (1998).

4.3.1 Five perspectives of Marks and Mirvis

In their 1998 book "*Joining forces: making one plus one equal three in mergers, acquisitions, and alliances*", Marks et al. identified five key dimensions on which managers should focus in order to manage a merger successfully, as seen in Table 2.

Table 2 The 5 perspectives (adapted from Marks & Mirvis, 1998, p. 275 et seqq.)

Dimension	Meaning
Strategy	Ongoing monitoring of strategic goals and addressing changes during the combination
Organization	Improve the organizational setup
People	Consider the people involved, and their respective feelings and attitudes towards the merger
Culture	Agree on a new culture
Transition Management	Carefully plan and monitor all elements of the transition

These five dimensions are, in fact, overlapping and interrelated (Marks et al, 1998). Using the five areas, managers can prepare a solid case for a merger, and ensure to forward as much information as possible to employees, stake-, and shareholders. Given that any combination is surrounded by a certain degree of unknown variables, it is imperative to attend to the dimensions and the respective questions they imply (Marks et al, 1998).

Table 3 The pre-combination phase (adapted from Marks & Mirvis, 1998, p. 276)

Dimension	Pre-combination
Strategy	Clarify strategy, rationale, and search criteria
Organization	Conduct thorough screening and due diligence
People	Prepare people psychologically
Culture	Respect the pre-combination cultures
Transition Management	Know where you want to go…and what it takes to get there

For this thesis, the pre-combination phase as seen in Table 3 is of substantial interest. The five areas are used to identify how a small airline can align its interest with the potential buyers and build a business case in favor of a sale.

4.4 Expert interviews

Due to the qualitative nature of this thesis, expert interviews were chosen as main research method. To better comprehend the nature of industry consolidation, its impact on small airlines, and the possibility of an auction process, interviews were conducted with different professionals within the aviation industry. Table 4 shows all interview partners and the respective interview type and length, fully transcribed to be found in Appendix 11.1.

Table 4 Interview Partners

Name	Position	Organization	Interview Type	Interview Length
Werner Enz	Editor, Aviation Journalist	Neue Zürcher Zeitung, NZZ	Face-to-Face	79 min
Dr. Michael Trestl	Head of Business Development	Swiss International Air Lines Ltd.	Face-to-Face	60 min
William Agius	Dep. Director Center for Aviation	Zurich University of Applied Sciences	Face-to-Face	70 min
Dr. Andreas Wittmer	CEMS Academic Director & Head of International Networks	University of St. Gallen	Face-to-Face	25 min
Thomas Krutzler	Chief Commercial Officer, Accountable Manager	People's Air Group	Face-to-Face	38 min

4.4.1 Method

The interview partners were selected according to their positions and the organizations they work for, in order to capture contrasting viewpoints. Airline executives from both a small and middle sized airline were interviewed, as well as different industry experts and analysts.

4.4.2 Procedure

All interview partners were personally contacted by email in advance in order to schedule an appointment. The interviews took place at the locations chosen by the interview partners and lasted between 25 and 80 minutes.

For all cases, the semi-structured interview type was chosen. According to Miles & Gilbert (2005), in a semi-structured interview there is a set of prepared questions to guide the discussion and clarify the covered topics. However, the conversation is left open to deviate from the subject in order to grasp other viewpoints. Miles et al. (2005) further explain how semi-structured interviews are ideal in researching qualitative rather than quantitative data. The Robert Wood Johnson Foundation (2008) remarks that due to the nature of the semi-free discussion it is hard for the interviewee to take notes. Consequently, it is best to tape the conversations and transcribe them for detailed analysis.

As suggested by Miles et al., (2005) the researcher started all interviews with briefing the interview partner about the general topic of the thesis and the aim of the interview. Some questions aimed directly at finding specific information, while others were more directed towards capturing the opinion of the experts. Moreover, as the interview partners all came from different organizations and different backgrounds, the questions used were not always identical. Hence, the contrasting viewpoints allowed a more flexible interpretation of the gathered information.

All interviews were recorded and transcribed word by word. Thus, the transcriptions found in Appendix 11.1 reflect the actual course of the interviews as well as their grammatical structure.

5 European industry trend analysis

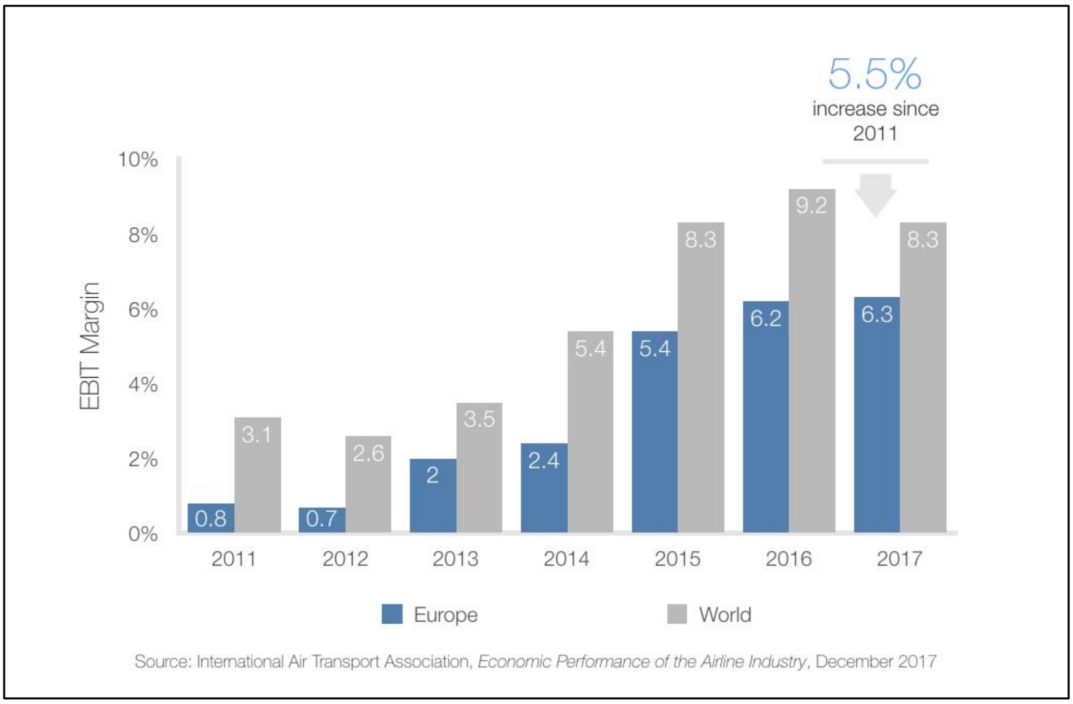
The following section analyzes the European industry trends by looking at different levels and developments, such as profitability, industry consolidation, and the competition between 'LCC' and 'Legacy' business models. Each section draws conclusions on implications for small airlines in the industry, before summarizing the trend analysis and the strategic impacts for small carriers.

5.1 Profitability levels

5.1.1 Margins and industry results

The global aviation industry is currently experiencing excellent results, with system-wide operating profits of $62.6bn in 2017 – this equals an average EBIT margin of 8.3 percent (IATA, 2017a). In contrast, as seen in Figure 8, the European industry is lagging behind, with EBIT margins leveling out at roughly 6.3 percent in 2017. Notably, this is a 5.5 percent increase in margins compared to 2011. Hence, the trend seems to be pointing upwards, with European airlines stabilizing and improving their profitability compared to global average.

Figure 8 Average EBIT Margins in % of revenues (IATA, 2017a, own illustration)



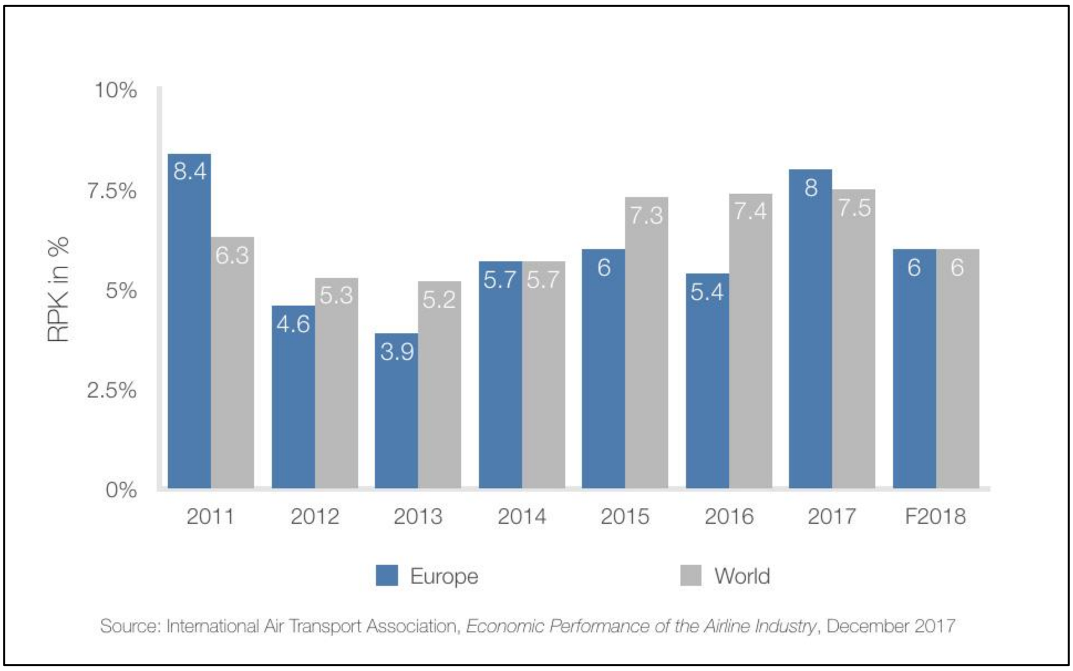
The growing margins can also be attributed to increased efficiency that follows industry consolidation. As Trestl mentioned: “Getting bigger means we can use more economies of scale, we can use more of the cost regression - these are the factors which lead to positive effects.“ (18 April 2018, Interview, Appendix 11.1.2)

It is noteworthy that the continuous growth in margins seen in Figure 8 could be misleading, as the upward trend cannot be forecasted accurately, and the industry might have arrived at a peak (PwC, 2017, p. 2).

5.1.2 Demand and supply developments

Figure 9 and Figure 10 give a glimpse of the development of Revenue Passenger Kilometers (RPK) and Available Seat Kilometers (ASK) respectively. Following structural overcapacity, both figures dropped until 2013, with airlines reducing the number of flights, and consolidation driving down overall system capacity. Growth has since caught on, with both global RPK and ASK growing at almost pre-crisis levels. The high percentage figures in 2015, 2016, and 2017 indicate high passenger demand and subsequent increases in seat supply.

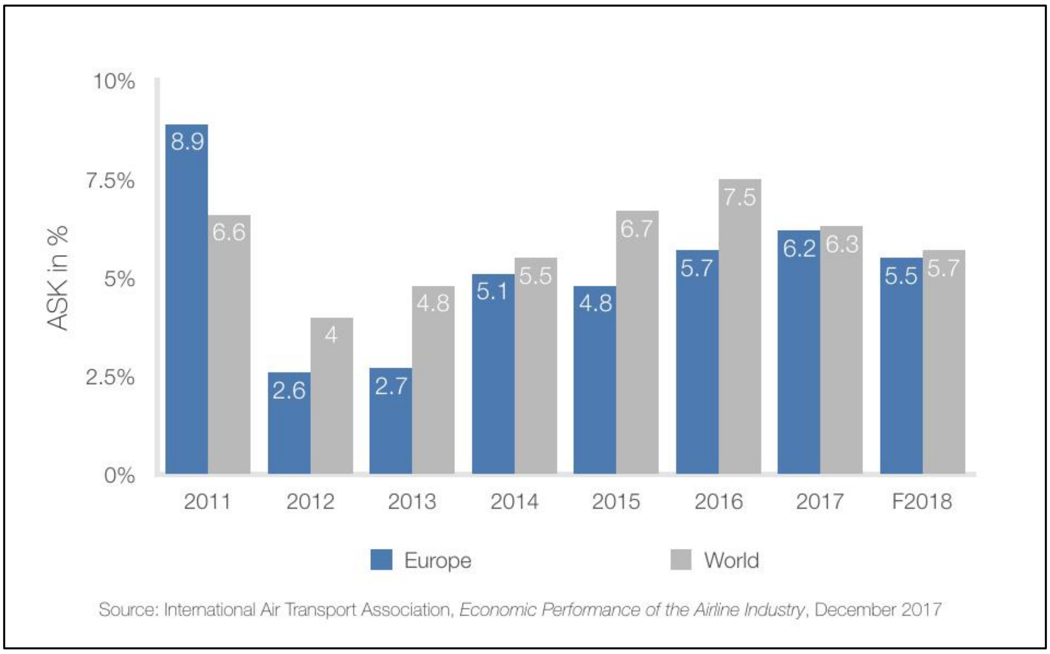
Figure 9 Revenue Passenger Kilometers (RPK) in % year-on-year (IATA, 2017a, own illustration)



However, and this can also be derived from the Figures 9 and 10, the forecasted numbers for 2018 (F2018) suggest that the fast growth has reached a cyclical peak in 2017. With the airlines increasing ASK and thus adding capacity, pressure will unfold on margins. Koenen (2018) reports that the failures of Monarch, Air Berlin, and Alitalia have not stopped the excess supply of seats - a supply that will even grow at 6 to 7 percent within the first half of 2018. The results are difficult to predict, and the capability to continue producing high margins and subsequent profits will largely depend on how efficient the individual airlines can manage their recurring cost structures. This then translates into competitiveness, as Enz explained: "In the industry competitiveness, connectivity is very important, so the quality of the routes you serve, and what recurring cost structure you have, since that is very crucial to remain competitive." (13 April 2018, Interview, Appendix 11.1.1).

SWISS for example has, by introducing the new triple seven to its fleet, produced significant overcapacity in its own market – and as the Swiss market is not large enough to fill these aircraft, the pressure is on the SWISS short-haul fleet to bring sufficient passengers to Zurich. This in return reflects on the pressure that lasts on the short-haul fleet and the margins it is able to generate (Agius, 23 April 2018, Interview).

Figure 10 Available Seat Kilometers (ASK) in % year-on-year (IATA, 2017a, own illustration)

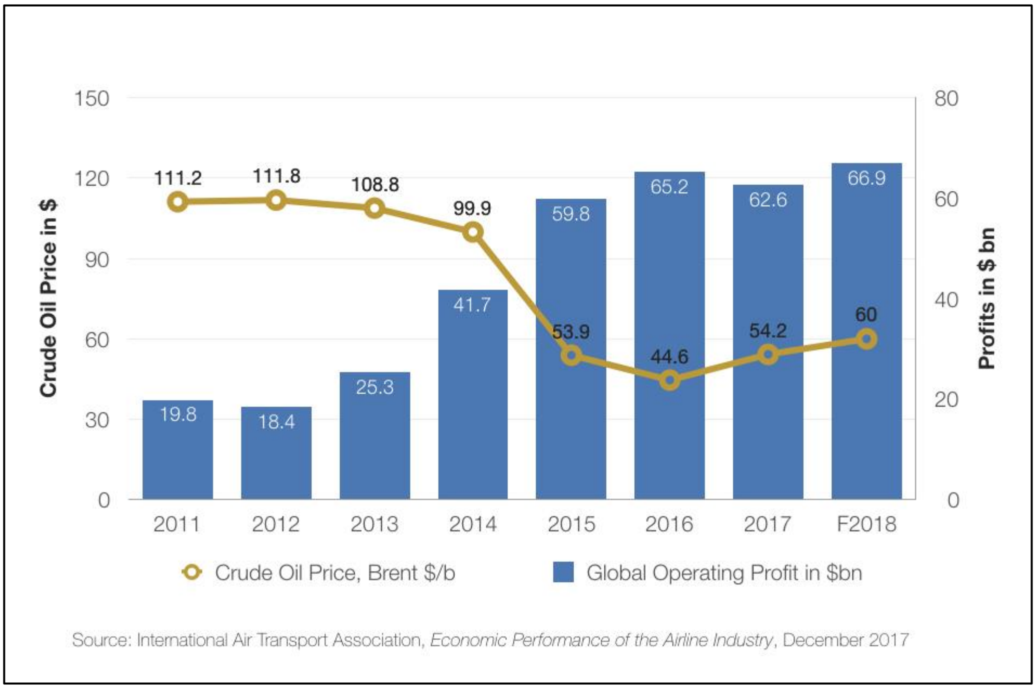


5.1.3 Oil prices

Finally, oil prices constitute a major part of airline expenses, and profits largely depend on how these prices develop. In the period between 2011 and 2017, fuel expenses averaged at roughly 27.6 percent in the global airline P&L (IATA, 2017a). Figure 11 shows the development of crude oil prices (in $ per barrel, left y-axis) within the same period, compared to the system wide operating profits (in $ bn, right y-axis). Though other factors such as consolidation and cost efficiency gains play an important part in the growth of profits seen in Figure 11, the author sees a correlation between the decrease in oil prices and the increase in profits. It is only logical to assume that, should oil prices significantly rise again, profits will decrease.

This also means that the capability of any airline to hedge this as risk is crucial in their attempt to remain competitive. Amadeo (2018) explains how oil prices have become less predictable, and how this volatility drives subsequent insecurities. The significant drop in the price of crude oil since 2012 has largely been beneficial for the airline industry. With a slight upward trend (seen in Figure 11, increase from $44.6 in 2016 to a forecasted $60 a barrel in 2018), it remains to be seen how airlines have adapted their cost structure in the meantime to cope with higher fuel expenses.

Figure 11 Relation of Crude Oil Price and Operating Profits (IATA, 2017a, own illustration)



5.1.4 Conclusions and implications for small airlines

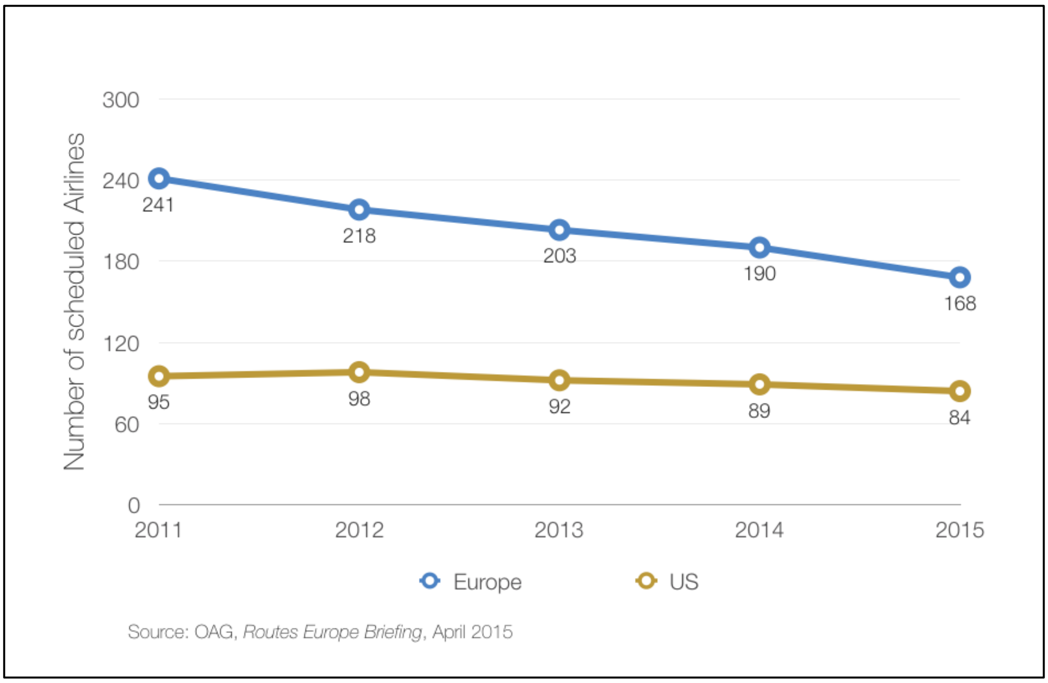
The growth in demand for air travel has also benefited the small airlines in Europe, and the low oil prices have allowed them to keep fuel costs low. However, the increase in capacity constitutes a challenge, as the large carriers can widely benefit from economies of scale and in-group synergies. For small airlines, the falling prices that follow an increase in supply, and an eventual rise in oil prices could prove to be very difficult to cope with in the coming years, especially if the industry has reached a peak.

5.2 Consolidation

5.2.1 General trend

As discussed in section 2.2, Europe finds itself in stage 2 of the consolidation life-cycle. It is likely, then, that this trend is going to continue as the industry progresses on the consolidation curve. Figure 12 shows the decline in the number of scheduled airlines operating within Europe over the time period of 2011 – 2015. In net terms the European aviation industry lost over 70 airlines during this period. During the same time span, scheduled airlines in the United States have decreased from 95 in 2011 to only 84 in 2015.

Figure 12 Number of scheduled airlines (OAG, 2015, own illustration)



The clear downward trend displayed in Figure 12 suggests that more airlines are probably destined to disappear. Taking into account the specific nature of the European consolidation, as discussed in section 2.2, market fragmentation may still lead to a higher number of scheduled airlines compared to the US – yet they might be flying under the name of one of the large airline groups (Ryanair, Lufthansa, IAG, Air France-KLM). The consolidation trend in Europe is confirmed by many industry analysts, including Dr. Michael Trestl, Head of Business Development with Swiss International Air Lines Ltd.:

> I think in general the European market tends to consolidate, so we see this - I don't want to say it's a mega trend - but it is a certain trend or at least a tendency towards consolidation and towards those rather small airlines becoming part of a bigger group of airlines. (2018, Appendix 11.1.2)

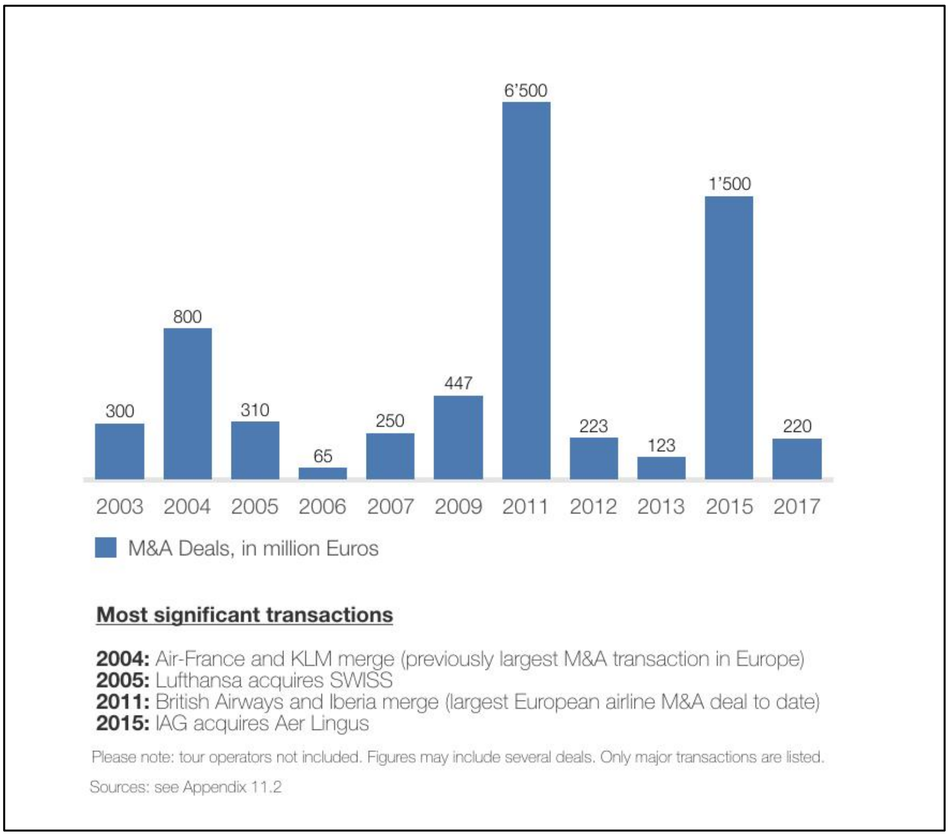
5.2.2 Future development of consolidation in Europe

The question arises whether consolidation in Europe will remain organic and steady, or if the industry will see some mega-mergers as has been the case in the American market. Figure 13 shows the most significant M&A transactions in Europe in the period from 2003 to 2017. Previously having been the largest airline transaction in Europe (and some sort of leading example), the 2004 merger of Air France and KLM has been overshadowed by two much larger deals in a little more than a decade – namely the giant merger of British Airways and Iberia in 2011, forming the IAG holding (deal volume €6.5bn), and the acquisition of Aer Lingus through IAG in 2015 (deal volume €1.5bn).

Again considering the consolidation curve, the following example illustrates how Europe might see some mega mergers in the future. If the numbers in Figure 13 are broken down into individual deals, out of fourteen, ten involve either IAG or the Lufthansa Group. The merger of Air-France KLM, then, is a stand-alone transaction.

As the large airline groups move along the consolidation curve to further build up scale, the possibility of IAG or Lufthansa Group trying to acquire Air France-KLM may not be unrealistic. Thus, the nature of consolidation may change to more of what the industry has experienced in the US: "I would assume that we are going to end up with the big three, as in the US. And within that we will probably have the other ones all linked to those." (Wittmer, 25 April 2018, Interview, Appendix 11.1.4)

Figure 13 Recent and important M&A deals in Europe (Appendix 11.2, own illustration)



5.2.3 Impact on prices

Consolidation in Europe has not had a significant impact on the general decrease in prices the industry has witnessed in the last two decades. Though there might be some short-term impacts on certain routes due to market adjustments, such as the monopoly of Star Alliance on the Zurich – Vienna route, pressure on prices remains. There appears to be no empirical evidence to support the case of rising prices (Trestl, 2018). Krutzler, CCO at People's Air Group also confirms: "[…] people compare prices much more often now. So the pressure on price will always be there […]" (25 April 2018, Interview, Appendix 11.1.5).

5.2.4 Diversity of choice

In the US, some analysts such as Kort (2017) lament the lack of diversity of choice for the customer, resulting from consolidation. In Europe, as seen before, consolidation is not as far advanced – and more airlines still operate in the market, automatically leading to more diversity of choice. However, this 'diversity' has also taken new forms:

- Concept of ‘self-hubbing’

  The market appears to have adjusted, now offering the customer all sorts of new possibilities. Due to complete price and fare transparency and a wide variety of booking platforms on the internet (Trestl, 2018), a passenger wanting to go from A to B can now book a low-cost flight from A to C, stay a night or two, and then continue to B. Instead of relying on one airline providing the entire service, the customer is much more free in choosing his or her travel itinerary (Agius, 2018).

- Dynamic pricing, buy-on-board, etc.

  New pricing models offer the customer free choice of what he or she wants to purchase – whether it is just the flight segment, or any additional service, the passenger can now take the offered services apart piece by piece and only pay for the individually desired aspects.

5.2.5 Efficiency

The efficiency gains from consolidation on margins and operating results can be observed in the chart presented in section 4.1.1. As the airlines consolidate, gains can mainly be realized on the cost side (Trestl, 2018). However, there are also limitations due to the nature of the European market. Conversely, in the US the question of location is much less important. For example, the Lufthansa Group has not yet centralized its flight training for the entire group in the most efficient and effective locations, but rather still operates different flight schools in different countries. This has to do with the fragmentation of the European market and the emotionality attached to certain aspects of the airline industry. Agius (2018) commented: “They are cost effective where they can be, and where politics don’t get in the way.” (Appendix 11.1.3).

Another example would be British Airways and Iberia. Though having merged, the differences in language, culture, and geographical location still require them to operate support processes at both ends, thus perhaps not fully realizing the possible gains in efficiency (Wittmer, 2018).

5.2.6 Conclusions and implications for small airlines

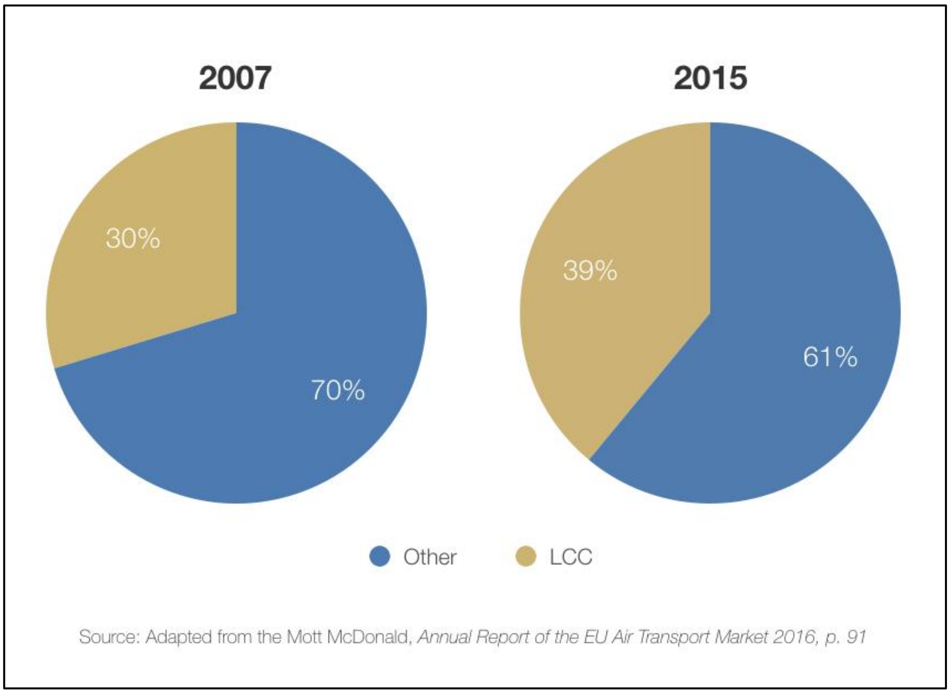
Consolidation in Europe will continue, as the large airline groups strive for more efficient operations. The growing influence of the big airline groups will put pressure on all independent airlines, as will the continuing decrease in prices. New airfare models offer the customer an increasing variety of how to arrange his or her travels. Since these pricing tools are expensive to construct, small airlines may have trouble keeping up with the customer's expectations. Furthermore, possible mega-mergers in the industry might completely change the rules of the game for small players.

5.3 LCC or Legacy

5.3.1 Rise of the LCC model

The concept of the LCCs has stirred up the European market quite significantly. As shown in Figure 14, Ryanair and other LCCs have managed to increase their market share by almost 10 percent in the time period between 2007 and 2015. Their model, thus, is simple and has surprised the traditional network (Legacy) carriers (Enz, 2018). The pressure the LCCs have unfolded on market competitiveness will be closer analyzed under section 6.1, yet it is important to note that it is likely that their market share will increase further in the future.

Figure 14 LCC EU market share growth 2007 – 2015 (Mott McDonald, 2017, p. 91, own illustration)



5.3.2 Convergence

What is observable in the market is some form of convergence of the business models of the LCCs and the Legacy carriers (Trestl, 2018). Both sides have adopted aspects of the other models; in case of the Legacy carriers, this is mainly the abandoning of the full-frills, F&B concepts on board. SWISS for example, although trying to position itself as premium airline, is now introducing buy-on-board from Geneva, and it will probably do so from Zurich as well in the near future (Agius, 2018). In turn, the LCCs are now more focusing on customer care, a concept formerly only adopted by the Legacy carriers. Interestingly, this convergence of business models makes it increasingly harder to distinguish the offered services – thus diluting the products, making it difficult for airlines to differentiate themselves.

5.3.3 Constraints and future developments

The two models are both constrained by infrastructure limitations. Most large airports in Europe already operate at full or even overcapacity (e.g. London Heathrow, Paris Charles de Gaulle). The trend of which model will prevail is hard to predict, however future developments might include one of the following:

- Long-haul and short-haul split

With increasing pressure on their short-haul fleets, the traditional network carriers may conclude that they will completely outsource their point-to-point traffic to a low-cost carrier and focus solely on intercontinental-routes. An example could be Lufthansa, already trying to outsource it's commuting traffic to Eurowings (Agius, 2018).

- Regulatory changes

A possible development could be restrictions on flight duration. This would mean that ultra-short connections within Europe would be prohibited and thus outsourced to trains or other substitutes. Such a prohibition would free up slots at important hubs for new and more lucrative destinations, and would eliminate parts of the competition – which would be welcomed by both the Legacy and the Low-Cost Carriers (Agius, 2018).

5.4 Conclusions

5.4.1 General conclusions

From the trend analysis, the following general conclusions can be derived:

- **Stable profitability, yet to be enjoyed with caution**

The European industry enjoys, along the global trend, stable profitability and has managed to continuously increase margins within the last five years (2012 – 2017). This is partly due to consolidation and cost synergies realized, but also attributable to a significant fall in crude oil prices. Though both ASK and RPK have grown in the last years, the failure of Air Berlin or Monarch have not resulted in less, but in more capacity. This over-supply of seats may put future pressure on margins. Forecasted profits also indicate the industry has reached a peak. Combined with a possible rise in the prices of jet fuel, the stability of the industry profits has to be looked at with caution.

- **Consolidation continues**

The European aviation industry has not reached the end of stage 2 on the consolidation curve. The large players will continue to build up scale and the sector might witness some mega-mergers in the future. The nature of consolidation may also evolve to more like what happened in the US, yet market fragmentation, at least for now, ensures the pursuit of multi-branding and multi-hubbing concepts by the large airline groups. Their efficiency gains are also limited to the extent to which the political and cultural landscape in Europe allows them to, whilst prices are anticipated to remain low or even decrease further.

- **Convergence of business models**

The LCC and Legacy business models will further converge, as the market tries to balance the two. For any smaller carrier, especially operating on short routes, the competition between those two models may pose a significant business risk. Furthermore, growing traffic and infrastructure constraints may lead to future changes in the business environment with significant impact on ultra-short routes.

5.4.2 Chances of survival for small airlines in Europe

Drawing from the conclusions presented above, the chances of survival for small airlines in Europe are ambiguous and to a certain degree very low. Considering the consolidation trend in the industry, and rising pressure on margins and prices combined with the growing influence of large airline groups, small airlines in Europe face an increasingly difficult business environment. Their importance for the market is also questionable, for example Helvetic and Skywork in Switzerland: “In my opinion, Helvetic and Skywork are both negligible, these airlines are not really needed for the market, (…), they are not relevant for the connectivity of Switzerland (…).” (Wittmer, 2018, Appendix 11.1.4).

Thus, consolidation forces will coerce these airlines to react and adapt to the evolving market situation in Europe. In conclusion, this means that small airlines will face a takeover rather sooner than later. Krutzler (2018), also confirms that he anticipates an offer in the future. “The question is more: a buyer for the group or just for the airline.” (Appendix 11.1.5)

Subsequently, this investigates the market forces in Europe, and the opportunities and threats for small airlines. Furthermore, the following chapters focus on identifying strengths that can be leveraged in a future M&A negotiation process, as well as finding possible stumbling blocks that need to be addressed in advance.

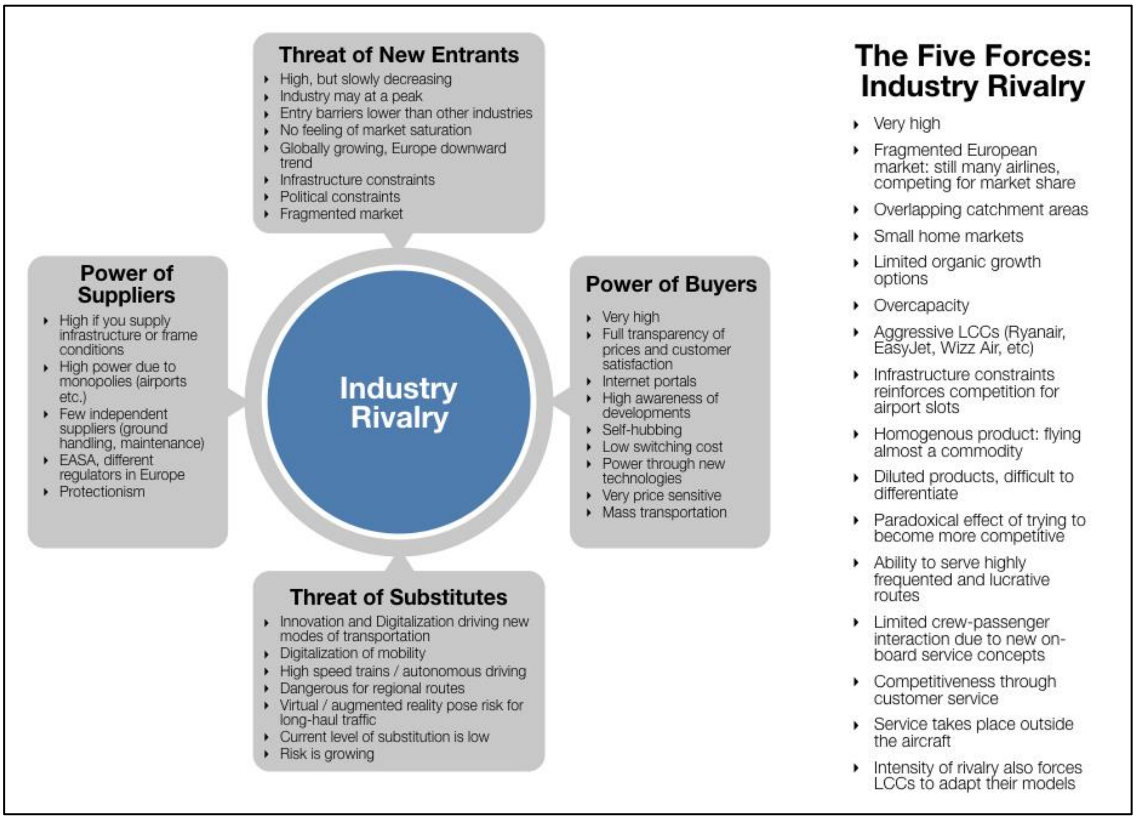
6 Market analysis Europe

The following section analyzes the European aviation market in more detail. It is important to note that the market for long-haul traffic is excluded from any analysis. Specifically, this section examines the competitive forces at work within the industry and their impact on small airlines. Moreover, it identifies the critical aspects in the airline value chain for the efficient value generation of small airlines before presenting their internal and external strengths and weaknesses in the SWOT analysis. The findings in this section are based on the conducted interviews, fully transcribed to be found under Appendix 11.1.

6.1 Porter's Five Forces, European airline market

6.1.1 The Five Forces in detail

Figure 15 The Five Forces at work in Europe (own illustration based on Porter, 1985)



The analysis of Porter's Five Forces as displayed in Figure 15 depicts the European aviation industry as a highly competitive sector with strong forces at work that impact on the overall industry performance. Below, each of the forces is analyzed in more detail.

6.1.1.1 The core: Industry Rivalry

Throughout the analysis, the intensity of rivalry within the intra-European aviation sector has been rated as very high. This can also be seen in the achieved margins of the industry compared to the global average (see Figure 8 under section 5.1.1). Due to the fragmented nature of the sector, still a large number of airlines is competing in a rather small market compared to the US for example (Trestl, 2018). The lack of large catchment areas (such as for example mega-cities like Tokyo or Mexico City) and thus the overlapping of these areas reinforces the airline's difficulties to attract enough passengers to fill their aircraft. The limited organic growth options of large players are fueling consolidation, and are leading Lufthansa Group and Co. to acquire more and more airlines (Enz, 2018).

The growth in demand for air travel has led the European airlines to produce significant overcapacity, which translates into heavy pressure on air fares. Moreover, the aggressive pricing strategies of LCCs has resulted in the paradoxical effect that, in their effort to become more competitive by lowering their costs by all means, most airlines have diluted their product to the extent that it has become hard to distinguish one from the other – in the end making them less competitive (Agius, 2018). This homogenous product, and subsequent price pressure, makes it increasingly difficult to justify their full-frills, F&B service onboard. Instead, more and more airlines are introducing new concepts such as buy-on-board, which limits the ability of the cabin crew to interact with the passengers, and thus allows them to only provide an adequate service level to those willing to pay extra. Agius (2018) underlined this trend: "If you are not willing to do that [pay extra for the food, A/N] - and I have noticed that myself - if you stick your ear plugs in you can go a whole flight and have zero interaction with the crew." (Appendix 11.1.3)

This mechanism worsens the Legacy carrier's capability to distinguish their on-board service from those of the LCCs (on intra-European routes).

In addition, the European aviation sector is operating at the brink of maximum capacity; almost all major airports are unable to increase the traffic volume any further

(Trestl, 2018, Agius, 2018, Wittmer, 2018). These infrastructure constraints amplify the strain on airlines to attain sufficient slots at lucrative destinations, such as London Heathrow or Paris Charles de Gaulle. Since such slots are a scarce resource, an optimal way to obtain them is by acquiring the airlines that are in their possession. A recent example thereof could be Ryanair, buying Laudamotion and with it the slots it owns at important German hubs (Krutzler, 2018).

The intensity of rivalry, then, has led to a change in how competitiveness may be defined within the European market. Considering that the main service of most airlines now takes place exclusively *outside* the aircraft, the respective level of customer care is the benchmark for competitiveness; that is, even Ryanair, formerly taking pride in completely neglecting the concerns of its passengers, has now adopted this philosophy (Trestl, 2018, Agius, 2018). The more exclusive, comprehensive, satisfactory, and complete an airline's customer care before and after the flight service is perceived by the market, the more competitive it is compared to its competition.

6.1.1.2 The Threat of New Entrants

According to Enz (2018), the aviation industry has lower entry barriers than other business sectors. Though needing to fulfil an extensive set of regulations, rules, and procedures, new entrants can quickly obtain an AOC by hiring industry experts. Given that there is a solvent investor behind the venture, new airlines can establish their operations relatively easily (Trestl, 2018). Plus, there appears to be a certain 'sexiness' in owning an airline – famous examples of billionaires trying to stir up the airline market are Nikki Lauda or Virgin Group Founder Sir Richard Branson (Enz, 2018).

In the European market, there seems to be no feeling of market saturation, nor has the industry reached any form of 'end state' (Agius, 2018) . However, recent events such as the failure of Alitalia, Monarch, and Air Berlin, combined with an intense industry rivalry, have lowered the risk of new entrants. Moreover, the already mentioned infrastructure constraints make it substantially more difficult for new entrants to establish operations at important hubs (Trestl, 2018). Political limitations and ongoing protectionism also shelter the industry from the influence of any foreign competitor, entering the market on a larger scale. Such ventures have enjoyed limited success, as the Air Berlin / Darwin Airline case has shown (Enz, 2018).

Rather, the risk is focused on M&A transactions that level the playing field amongst the large groups, such as the merger of British Airways and Iberia or the acquisition of Air Berlin trough the Lufthansa Group.

6.1.1.3 The Power of Buyers

The power of buyers has grown since the liberalization of the aviation industry. The internet and the buyer's ability to access information has resulted in complete price transparency. Internet portals such as *booking.com* or *Trip Advisor* ensure full customer satisfaction transparency, along with the possibility of self-hubbing (Trestl, 2018, Agius, 2018). That is, the customer can put the service together the way he or she likes.

Through the rise of the LCCs, air travel has become a means of transportation for the masses. Very price sensitive customers now constantly compare fares and services, basically lowering their switching cost to the level of virtual non-existence. This gives them the power to select the carrier with the most optimal connection and the cheapest price, and the passenger's loyalty is decreasing vis-à-vis the product quality (Agius, 2018). Combing back to the paradoxical effect mentioned before, this means the power of buyers has resulted in the airlines blending their products into one, solely focusing on lowering ticket prices. To mitigate the power of the customer, airlines now need to put emphasis on services provided around the actual flight from A to B.

6.1.1.4 The Power of Suppliers

The power of suppliers depends on the commodity provided. Any supplier offering infrastructure usually enjoys high bargaining power, as there are constraints that cannot be stretched. These suppliers often operate in monopolistic environments. An example in Switzerland is Zurich Airport. Though the location is very lucrative and favorable, the growth options are tightly limited and often blocked by public or political initiatives (Trestl, 2018). This means any airline wanting to operate in and out of Zurich has to take whatever the airport offers, at the price dictated by the airport management. If you are unwilling to pay the respective fees, another airline will gladly take over the few available slots.

Furthermore, the suppliers providing the frame conditions also enjoy high bargaining power. Regulators still hinder certain developments within the industry (Krutzler, 2018). Altenrhein's People's Air theoretically experiences sufficient customer demand to be able to increase its number of flights. However, constraints put on opening hours of the airport by the bilateral agreements between Switzerland and Austria hinder such developments.

Lastly, continuous growth of the industry has led to long waiting lists and respective backlogs in the books of aircraft manufacturers such as Boeing and Airbus. Limited competition amongst these suppliers (mainly Airbus and Boeing) also increases their bargaining power vis-à-vis the airlines (Wittmer, 2018).

6.1.1.5 The Threat of Substitutes

Thus far, the aviation industry has only seen limited substitution, mainly in the form of more sophisticated train connections. Since it is easier to establish new air-routes than on-ground train lines, the risk is somewhat limited (Krutzler, 2018). However, innovation and digitalization of mobility may increase the threat of substitution in the future. Trains pose a significant risk for regional routes, whereas technological advancements such as autonomous driving and virtual / augmented reality may give birth to new modes of transportation (Trestl, 2018).

6.1.2 Conclusions and implications for small airlines

From the above presented analysis of Porter's five forces, the following conclusions can be drawn for small airlines:

- **Inability to compete**

The intensity of industry rivalry, combined with the fragmentation of the market make it almost impossible for small airlines to compete on lucrative routes. The pressures on prices worsens the competitive force, as small airlines cannot realize economies of scale.

- **Development constraints**

Limitations put on infrastructure and the power of suppliers thereof make it difficult for small carriers to expand their network to lucrative destinations, as new slots are extremely rare and very costly to acquire.

- **The forces are fueling consolidation**

The interplay of the five forces at work play into the hands of consolidation. That is, the limited possibilities put on corporate developments by the power of the different forces can be somewhat circumvented by the means of M&A transactions. Thus, combined power can be leveraged against the other forces within the industry, and competitiveness can be increased by creating system-wide synergies in a consolidated group. For small airlines, this means their market positions are all but safe, as the big airlines increase their 'shopping' activity in search for lower costs and higher margins.

- **The threat of substitution is highest for the smallest**

As small airlines often service short-haul routes and regional connections, the threat of any substitute products is higher for them than for airlines also flying long-haul. This means the regional connections can easily be served by trains or other, future means of transport that might come up through technological innovations.

6.2 Value chain of small airlines

The above presented analysis of the competitive forces at work showed how airlines are pressured to constantly lower costs to remain competitive. As conceptualized by Porter, the value chain contains the major cost drivers as well as sources of differentiation (MindTools, n.d.). Identifying such activities within the chain is crucial in developing efficiency and competitive advantage.

This section therefore aims at identifying the key factors in the value chain of small airlines, and in what activities within the chain they might possess an advantage compared to larger airlines or consolidated airline groups.

6.2.1 Airline value chain

Transporting passengers from A to B is the main activity of any airline. The provided service, however, relies on an extensive set of activities that need to take place in sequence or simultaneously. The supply of infrastructure (such as airports, slots, frame conditions) allows the airline service to be performed and prepared on ground, while the manufacturing industry supplies all the equipment needed such as aircraft and spare parts. These suppliers stand at the very beginning of the airline value chain.

Figure 16 Airline Value Chain (Albers, Koch & Ruff, 2005, p. 2)

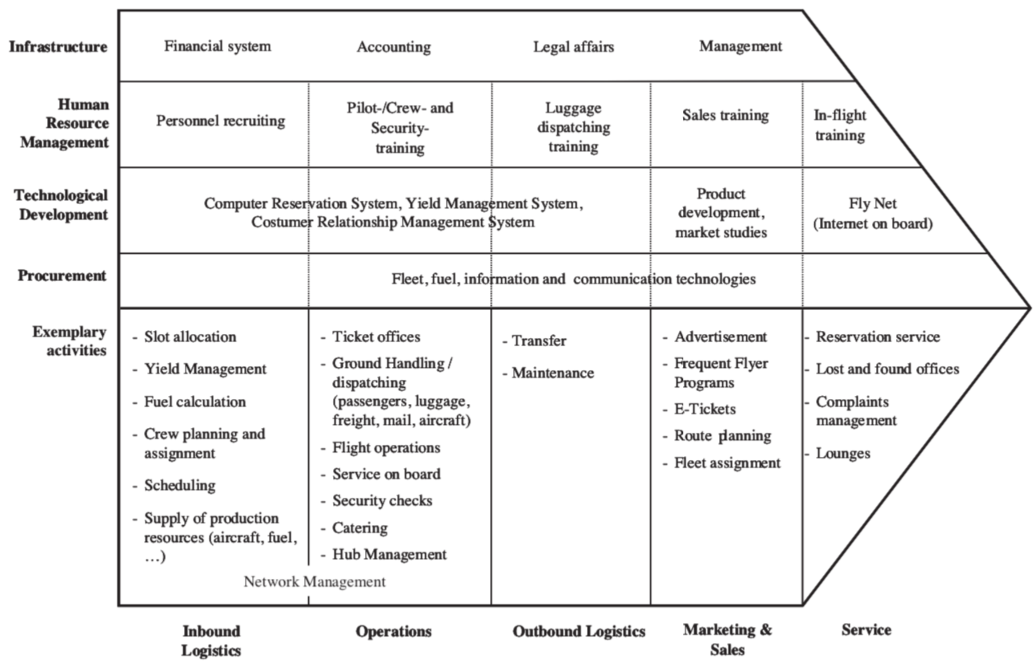


Figure 16 shows the generic airline value chain as conceptualized by Porter (1985), divided between primary and support activities. Therein, Albers et al. (2005) identified the subsequent activities performed by the airline after the initial infrastructure and frame conditions are set.

6.2.2 Efficiency and its obstructions

According to Trestl (2018) and Krutzler (2018), efficiency in the airline value chain starts with operations. This entails the initial setup of the aircraft layout, seat configuration, network design, and subsequent operating model. “I would really say that we for ourselves have to set a good foundation for efficient operation. And then everybody else has to feed in it.” (Trestl, 2018, Appendix 11.1.2)

As seen in Figure 16, Inbound Logistics also cover constrained supplies such as airport slots and the production resources. As seen in the Porter’s 5 forces analysis under section 6.1.1, an airline cannot simply require an increase in the delivery in slots. Trestl (2018) described how the providers and suppliers within the value chain all need to ‘sit at one table’ and work towards the joint goal of efficient operations. The previously mentioned power of suppliers, especially of infrastructure, influences the airline’s ability to improve its own efficiency in these activities, and must be negotiated constantly.

Furthermore, small airlines cannot perform all activities by themselves but have to outsource certain aspects. “[…] there are many areas which we cannot handle ourselves because we are simply too small. For example, maintenance which we buy from a supplier that already has this efficiency in house […]” (Krutzler, 2018, Appendix 11.1.5) This means any small airline has to identify the activities it can perform most efficiently on its own, and then leverage those value drivers to improve their cost structure.

6.2.3 Key value chain factors for small airlines

Unlike large airlines or consolidated airline groups, small carriers can hardly realize any economies of scale within their value chain (Wittmer, 2018). The question arises as to what activities act as the value factors for small airlines in order to reduce costs or keep them at a low base.

6.2.3.1 Human Resources

Wittmer (2018), Krutzler (2018), and Agius (2018) all agree that the most important factor for small airlines lies in Human Resources. Krutzler (Appendix 11.1.5) stressed that "[…] the big advantage of us as People's Group is that our staff is basically multi-functional. […] So our efficiency lies in the HR or staffing function." That is, most employees do not just execute one job, but rather cover multiple profiles and perform different tasks as needed.

Agius (Appendix 11.1.3) described how "They [small airlines, A/N] have a much lower cost base, both in terms of salaries and in terms of the costs that are required for the production of their services" and that "The airline industry is very labor intensive". Trestl (2018, Appendix 11.1.2) supports this argument, stating that "[…] very often the cost structures are very favorable in terms of regulation." Krutzler (2018) adds: "A large advantage if you are small and independent is also that you are not bound by collective wage agreements." (Appendix 11.1.5) Wittmer (2018) delivers a practical example of how Helvetic Airways is leveraging the HR function:

> If we look at Helvetic and SWISS, it would be easy to just take over Helvetic. These planes fly already for SWISS and it would be rather easy. What's the reason SWISS is not doing this? It's very simple: Helvetic pays lower salaries than SWISS does. SWISS unions demand higher salaries, pilots earn more, so for them it's a good deal to keep them in a separate company. (Appendix 11.1.4)

By implication, this means the HR function is a crucial driver in the value chain of a small airline. Other influential factors for small airlines are to be found in logistics as well as marketing and sales.

6.2.3.2 Logistics

This especially includes the activities of Crew Planning and Scheduling. Small airlines often serve short and regional routes and focus on a very specific niche. According to Trestl (2018, Appendix 11.1.2), small airlines tend to "[…] having a high degree of specialization which means high customer orientation, and also a high degree of vertical range." This results in 'speed to market and flexibility'.

This view is supported by Enz (2018, Appendix 11.1.1) stating that "[…] they are maybe more flexible in adapting certain flight plans." Whereas large airlines are more bound by customer expectations to 'always offer that flight to Kiev', smaller carriers can react faster, and adapt their schedules accordingly if a route cannot be operated profitably.

Lastly, less regulation on labor or less obstruction through unions also allows the airline a higher degree of flexibility in their crew planning. For example, Krutzler (2018, Appendix 11.1.5) mentioned that "We have people employed both as cockpit and cabin crew." This fact, combined with "[…] the strong company spirit often seen within small firms […]" (Enz, 2018, Appendix 11.1.1) enables the small airline to react quickly. Furthermore, any employee executing more than one job profile also permits the company to save costs and resources, as certain tasks of familiarization must be performed only once instead of twice or more.

6.2.3.3 Marketing and Sales

Agius (2018) and Krutzler (2018) both identified Marketing and Sales as another key factor for small airlines. First, small airlines do not have to maintain expensive frequent flyer programs. However, according to Agius, this is not only an advantage since it is precisely these programs that attract recurring passenger streams. Second, the resources saved on costly promotion programs can then be invested in other tools to boost the regional service. Krutzler (2018) explains that "[…] these days you can have very cheap and efficient marketing." (Appendix 11.1.5) He further elaborates on the importance of making use of the wide range of new tools available today. This way, a small airline can leverage its position despite not having a high marketing budget.

6.2.4 Value chain integration

Consolidation offers the possibility of integrating the value chain into a larger system of activities, hence to profit from synergy potential that arises through said integration. For small airlines, this means they might be able to leverage their value drivers while simultaneously benefiting from efficiency gains.

Wittmer (2018) stressed the fact that support processes can easily be integrated, and therefore synergies can be created to improve efficiency. However, he also explained that "[…] because you are in geographically different locations […] you need support processes and firm infrastructure on both sides. There it is questionable how much integration you can generate." (Appendix 11.1.4) Wittmer further elaborated on how airlines can create synergies in procurement, technology development, and in operations. Interestingly, procurement was identified as an essential weakness in the value chain of small airlines by Trestl (2018, Appendix 11.1.2): "So if such a small airline wants to purchase an aircraft you are more or less really then alone on the market, so you are not able to leverage on any purchasing synergies which you might have as part of a bigger group […]" This lack in purchasing power is also reflected in People's Air's difficulties in financing its fleet expansion, which in turn is important to improve efficiency (Krutzler, 2018).

According to Wittmer (2018), integration is supported by alliances and networks, and airlines that operate within such systems. Prominent examples of airlines that only fully merged after having harmonized their value chains over many years are Air France-KLM (Sky Team Alliance) or BA-Iberia (one World Alliance). Wittmer (Appendix 11.1.4) concludes "[…] and then integrate fully by merging - it is just the last step of a long process which you have conducted in the network and by going through different levels in the alliance." However, Wittmer also outlines that Alliances have more revenue- than cost synergies, and if an airline is looking for cost reduction, merging is the logical choice. Alliances then, have their raison d'être, but Trestl (2018), confirms that the more attractive leverages are on the cost and not the yield side, which is essentially why the above mentioned companies eventually merged.

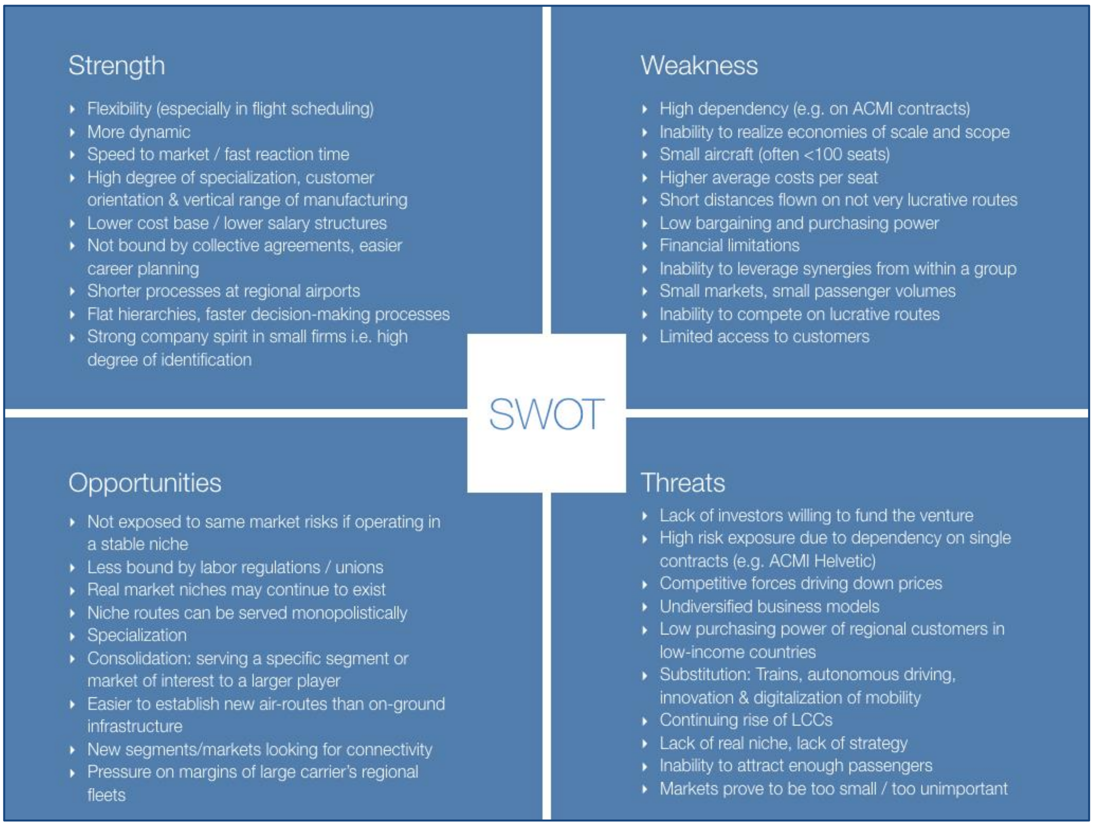
Finally, the value chain integration offers strategic possibilities for small airlines, especially in the activities in which they can operate more efficiently than large carriers such as Human Resources. Integration, then, does not necessarily mean full integration, but can also take place on the basis of e.g. ACMI services as in the case of Helvetic Airways, which has specialized in providing wet-lease services to other airlines because it can do so on a cheap basis (Trestl, 2018). Moreover, Krutzler (2018, Appendix 11.1.5) adds that "If you have cheap and efficient staff that is an advantage, because every consolidated group is searching for cheap platforms to put pressure on the expensive ones."

Agius (2018) elaborates on the pressure the Legacy carriers experience on their short-haul fleets and how outsourcing this activity could improve margins. Thus, he suggests the point-to-point traffic will be left to those operators that can execute these flights most efficiently, while the long-haul connections will be the domain of the traditional legacy carriers. Some of these processes are already ongoing, as seen in Lufthansa's endeavors to keep up with the LCCs capabilities by outsourcing parts of its short-haul traffic to Eurowings. Agius even envisions that this is only the start: "So theoretically we could also end up in a situation where all of Lufthansa's short-haul traffic is outsourced to Eurowings - out of necessity." (Appendix 11.1.3)

Consequently, this means that small airlines could serve as cheap platforms for the large carriers and their groups, leveraging the key factors in their value chain – mainly cheap human resources and flexible scheduling.

6.3 SWOT of small airlines

Figure 17 Summary of SWOT Analysis of Small Airlines in Europe (own illustration)



As outlined in section 4.2, the market analysis first investigated the external forces influencing the market and its players before the value chain analysis identified the key factors for small airlines within the chain. To follow the proposed step-down approach, this section will ascertain the internal strengths and weaknesses as well as the external opportunities and threats for small airlines.

The most relevant topics found per category are summarized in Figure 17. Thus, the analysis as outlined below shows that small airlines have a very distinct set of internal and external factors that influence their chances of survival.

6.3.1 Strengths

Some of the key strengths of small airlines discovered throughout the analysis are flexibility, fast reaction time, and speed to market (Trestl, 2018). Through a high degree of specialization and customer orientation, such airlines can quickly adapt their flight scheduling. Since they are so specialized in very concrete niches, small airlines often have a high degree of vertical range, that is, the degree of how well they know their specific market segment (Trestl, 2018). An example is People's Viennaline, only serving the route Altenrhein (CH) to Vienna (A), but multiple times a day and for a very specific customer segment. Should this segment demand an earlier departure of the first morning flight, People's will be able to not only quickly pick up the sentiment but also amend its flight plans. Wittmer (2018) adds "Smaller companies, more flexible and more dynamic, can react better on markets […]" (Appendix 11.1.4) Thus, the resulting strengths is speed, which can be used to react more quickly to shifts in customer expectations or market needs.

Furthermore, lower salaries and a subsequently lower cost base contribute to the advantages small airlines hold over larger players (Agius, 2018). This is supported by less pressure from labor unions or less restrictive regulation, as Trestl (2018) argues "[…] often the cost structures are very favorable in terms of regulation, so very little regulation given by unions or labor regulation." (Appendix 11.1.2) The lack of pressure from such unions is reflected in the absence of collective wage agreements, allowing small airlines to keep costs low over a long time period (Krutzler, 2018).

Additionally, small firms often profit from shorter decision-making processes, flat hierarchies, and a strong company spirit. This allows small carriers to more easily align their staff with the company vision and its strategy and plays into the mentioned strength of speed and fast reaction time. Thus, everyone is more involved, leading to a higher degree of company identification (Enz, 2018).

6.3.2 Weaknesses

Interestingly, some of the aforementioned strengths are, to some degree, also weaknesses of small airlines. Though they can react faster on markets, small carriers are also more dependent on them (Wittmer, 2018). A prominent example are airlines relying on ACMI contracting, such as Helvetic Airways. Since actual demand for air travel is hard to predict, so is the degree of utilization of airline fleets, and subsequently the market need for ACMI contractors (Krutzler, 2018). Some cost advantages also turn out to be a weakness of smaller airlines, as Agius (2018) pointed out:

> They have less costs because they are kind of not burdened down by thing as a rule - like having to operate an effective hub. They don’t have to maintain any frequent flyer programs which are incredibly costly. But on the other hand it’s precisely things like frequent flyer programs or operating kind of a hub / network that kind of attracts customers. And I think that’s what most of the smaller airlines in Europe struggle with. (Appendix 11.1.3)

Another major weakness of small carriers is their inability to realize any economies of scale to optimize the efficiency of their operations (Trestl, 2018). Moreover, they usually serve short and not very lucrative routes with small planes that often seat less than 100 passengers. Because the costs per passenger are higher on small aircraft, this is an essential weakness, impacting on profitability and the revenues small airlines can generate. Finally, it is hard for small airlines to attract sufficient passengers in their small markets to fill their aircraft (Wittmer, 2018). Generally formulated, this can be summarized as follows: “Any plane that has less than 100 seats is not really getting you into profits.” (Wittmer, 2018, Appendix 11.1.4)

Trestl (2018) also finds the limited purchasing power and lower financial capabilities to be an essential weakness of smaller players. Furthermore, they lack the ability to profit from any purchasing synergies which large airlines might have due to their consolidated nature. Consequently, this limits the small carrier’s ability to compete on lucrative routes with high growth in demand for air travel, since large airlines can quickly increase their capacity. A simple example thereof is Skywork, trying to compete on the Basel-Vienna route:

> […] inevitably the consequence was that no sooner had they announced that they would open the route, that EasyJet started operating the route, and Austrian Airlines shifted from a Dash 8 to the Embraer 190 - kind of eliminating the competition by capacity. (Agius, 2018, Appendix 11.1.3)

6.3.3 Opportunities

The fragmented European market still offers opportunities for small airlines, such as operating in very specific niches and monopolistically exploiting such segments (Wittmer, 2018). Moreover, the fewer constraints put on such small players through the mentioned absence of labor unions provides further opportunities to grow or enter certain segments that would be unattractive otherwise (Enz, 2018). Such real market niches may continue to exist within the European market. Furthermore, within these niches small players are not exposed to the same market risks as large airlines (Trestl, 2018). Enz (2018) also sees opportunities in tapping markets that are looking for connectivity: "Here or there you might be able to establish something new if you have the right market feeling for it, maybe also in cooperation with the airport authorities in the target country." (Appendix 1.11.1)

Another opportunity arises from providing services to large airlines that experience pressure on their short-haul fleets. As elaborated under section 6.2.4, small airlines can thus leverage their cost advantages to act as cheap platforms. Wittmer (2018) suggests this could also mean that a large airline 'buys' itself a small airline to operate these short flights on a more profitable basis.

Lastly, certain opportunities could arise from strategic advantages a small carrier might hold. This includes for example possessing valuable airport slots, a modern fleet, or serving a customer segment another player is particularly interested in. As to why SWISS bought Edelweiss in 2008, Trestl (2018) explains: "[…] because it was a favorable cost structure, it was also enabling SWISS and with SWISS the Lufthansa group to tap into the leisure segment here in Switzerland with an already existing customer base." (Appendix 11.1.2)

6.3.4 Threats

Small airlines face numerous threats that could potentially endanger their existence in the future. In particular, this includes the fact that small carriers need an investor that is willing to support the venture with capital (Wittmer, 2018). As Narkhede (2017) explains, liquidity is a key indicator of financial health of airlines. Thus, as seen in the example of Skywork, the difficulty in finding an investor can be a credible business threat (Schmid & Flottau, 2017).

Furthermore, the dependency of airlines relying solely on ACMI contracting is a threat waiting to materialize. According to Agius (2018), Helvetic "would definitely not have such a large fleet as they do now if it weren't for SWISS" and "everything that Helvetic has tried in the past de facto failed" (Appendix 11.1.3) Krutzler (2018) adds that this business form is "very difficult to calculate and difficult to predict" (Appendix 11.1.5)

Other threats are to be found in the growing competitive pressure and the increasing influence of LCCs in Europe (Enz, 2018). The inability to compete on price threatens the very existence of small airlines. Adding to this the threat of pursuing an undiversified business model (Krutzler, 2018), and the lack of a real niche means to compete against the large players, which in reality a small airline cannot beat: "Austrian Airlines and EasyJet are only trying to kill Skywork, and once they have achieved that we can assume that Austrian will return to using the Dash 8 and the prices will go up again." (Agius, 2018, Appendix 11.1.3)

Finally, small airlines are also threatened by substitution and the risk that their markets prove to be too small to attract enough passengers. Especially in markets with low purchasing power it can be very difficult for regional carriers to even cover their recurring costs (Krutzler, 2018). Thus, substitute products may offer a more convenient way to cover these regional distances, as Trestl suggested "[…] especially for those kind of smaller airlines focusing on regional routes, you could ask if it's more practical and also more efficient for someone to take a self-driving vehicle to go from Zurich to Geneva or to Lugano." (2018, Appendix 11.1.2)

However, Krutzler also pointed out that “[…] out of Switzerland it makes perfect sense that routes that aren’t necessarily high frequent ones are being served by regional carriers.” (2018, Appendix 11.1.5)

Concluding, one can say that it has been showed that this only works if such airlines serve a very specific niche (such as People’s Viennaline) and are able to attract sufficient passenger streams with adequate purchasing power.

This chapter has conclusively shown where small airlines hold strengths and weaknesses, and has identified external opportunities and threats. The following chapter aims to determine whether proactivity can be beneficial to achieve a higher transaction price. Further, it will derive key success factors for small airlines imperative to leverage the gains promised by proactive action. Thus, the conclusions from the previous analyses substantially contribute to the findings in Chapter 7.

7 Merger success factors for small airlines

This paper proposes that, in light of industry consolidation, small airlines in Europe will be faced with takeover threats sooner or later. As seen in chapter 5 and 6, the market forces within Europe are heading towards more intense M&A activity, and this trend is congruent with the identified threats for small airlines.

Thus, this section will analyze if a proactive approach to sell oneself can be beneficial for small airlines. Furthermore, by using the five perspectives of Marks and Mirvis, it aims at identifying the Key Success Factors (KSFs) for small airlines in order to successfully build a business case for an M&A transaction. The findings are based on the conducted expert interviews, in full to be found in Appendix 11.1.

7.1 Benefits of proactivity

Almost all interviewed experts agreed about the fact that a proactive approach can, from a management point of view, be beneficial in the attempt to maximize the transaction revenue. That is, the position from which a small airline starts negotiating can be more advantageous if the airline actively reaches out to potential buyers (Trestl, 2018). Wittmer (2018) suggests this to be a 'smart way of thinking about it' and adds that "Otherwise you are taken over. And if you are taken over, you are taken over at the rules of the other party, and you don't have much to say." (Appendix 11.1.4)

Agius (2018), however, disagrees, stating that "[…] basically what you are saying is that we're becoming increasingly desperate. And once it becomes apparent to your opponent that you are desperate, they dictate the price." (Appendix 11.1.3)

Trestl (2018) concurs with this viewpoint, underlining that "if you have to sell yourself because you are in a for example bad financial situation and you are looking for relief […], the price which you might be able to achieve for your airline could be lower than if you would proactively approach airlines." In essence, this means that, unless the firm finds itself in financial trouble, the proactivity gives one an important edge "because you are flexible. You don't need to sell - you can sell." (Appendix 11.1.2)

The underlying question of whether such a strategy makes sense is also to be found in the business model and the current market situation (Trestl 2018, Krutzler, 2018). The management must question its business model sustainability, and how their niche markets might develop in the future. Markets can move incredibly fast, and a convenient situation can become inconvenient quite quickly (Enz, 2018).

Finally, selling also means giving up control, and with it the entrepreneurial freedom. As elaborated under 6.2.4, the integration process however can be supported by first entering into alliances, and thus interests can be aligned over time. Hence, it could make sense to take a 'slow-motion', yet proactive approach, as Wittmer (2018) explained: "This way you could rather find a partner and say let's integrate in five years from now, and in those five years we work towards it in close collaboration." (Appendix 11.1.4)

In conclusion, it has been shown that a proactive approach towards an M&A deal can indeed prove beneficial for small airlines, considering the different factors behind such a decision. Thus, three distinct KSFs were identified that are crucial for small carriers in their attempts to develop a business case for a potential buyer.

7.2 KSF 1: Strategic Niche

The first key factor is the strategic niche. The niche is important because it gives the small airline the reason to exist; since it cannot compete on the highly frequented routes, it must specialize in a niche where there is a certain demand for air travel within a certain segment, all whilst competition is benign in that very segment. "Small airlines need niches, otherwise it doesn't work", Wittmer (2018, Appendix 11.1.4) emphasizes. If the segment or niche is attractive enough, it can prove to be a KSF when entering into negotiations with a large player. Marks et al. (1998) highlight how the strategic fit impacts the integration process. That is, if the strategy of the buyer does not align with that of its target, the integration will prove difficult. The niche however offers the buyer something he is potentially interested in, such as quick market access or tapping a specific customer segment (Trestl, 2018). Furthermore, the niche may also offer an extension to the buyer's network, basically ready-made (Agius, 2018).

Though the strategic fit is the first aspect to look at, Trestl (2018) elucidates that even if an airline offers a strategy in line with the intentions of the buyer, the frame conditions may prove to be less favorable. This leads to the second KSF presented below.

7.3 KSF 2: Organizational Fit

Marks et al.' (1998) dimension 'organization' entails the building of a better firm, leveraging the advantages the combination offers. The second important factor therefore contains the actual assets the seller has to offer, and how well these assets fit into the organization of the buying airline (Trestl, 2018). For Wittmer (2018) this is primarily reflected in the cost structure and the availability of planes, as well as airport slots. Here it is important to note that the buying airline is first and foremost interested in the offered assets (Wittmer, 2018) and the increased market access these assets bring (Enz, 2018). A modern fleet, tight organization, flight hierarchies, and favorable cost structure are therefore a key success factor for small airlines in their negotiation attempts. Krutzler (2018) summarizes "If you are reliable and have a good service, you have something to show, which helps you to leverage your stand point." (Appendix 11.1.5)

The importance of organizational fit is underlined by a statement a Lufthansa executive made to Enz (2018), saying that "(…) but do we have to buy an entire airline or do we just need new planes? Planes which we can acquire much cheaper this way than if we buy them from Airbus directly.“ (Appendix 11.1.1)

Hence, the KSF of organizational fit contains the small airline's ability to trim its organization, maintain a modern fleet, and know the asset worth in its books such as the value of airport slots in its possession. This combination may motivate the buyer to purchase the entire firm.

7.4 KSF 3: People and Staff

The third factor, and maybe most important, is the dimension termed 'people' by Marks et al. (1998). This involves the actual humans affected by the transaction, their feelings and attitudes towards the deal and their subsequent behavior. To be informed about the sentiment within the company is crucial and "Combinations have the potential to affect employee morale and productivity, work processes and quality, group and intergroup relationships, customer service and satisfaction, and practically every other aspect of organizational life." (Marks et al., 1998, p. 258)

As the airline industry is highly emotional (Agius, 2018) and people consider having aviation as part of their DNA (Wittmer, 2018), this dimension quickly identified as a KSF.

One of the main advantages of smaller airlines is their lower cost base due to generally lower salary structures, as explained in chapter 6. This strength can be leveraged when negotiating with a potential buyer. However, and here it becomes tricky, the small airline must ensure the alignment of its staff with the strategic intentions. That is, once the transaction is announced, the airline staff will get into direct contact and subsequently demand equal pay (Agius, 2018). This means the cost advantage of the small carrier, and with it one of the prime arguments, vanishes. Such a scenario can be avoided by creating different firms and by not fully integrating, as has been the case after Crossair had bought the bankrupt Swissair in 2002. The new companies were named SWISS Global Air Lines Ltd. and SWISS International Air Lines Ltd., respectively (Wittmer, 2018). Reconciling this issue however took SWISS several years, as the involved people were all but happy about the situation (Agius, 2018). For years, the pilot corps were split into "the Swissair" and "the Crossair" guys, creating a sense of hostility within the company. Even so, the example of SWISS is not necessarily representative, as it is logical to assume that people working for the same company demand the same salary for the same type of work. Thus, the risk may also be mitigated by keeping separate brands, as is the case with Edelweiss (Trestl, 2018). Therein, Edelweiss management has somehow accomplished that their employees accept lower salaries than their SWISS colleagues (Wittmer, 2018).

This alignment of people and staff, then, is imperative in retaining the advantages of a small airline as outlined under section 6.3. Thus in the case of Helvetic being acquired by another airline for example, Wittmer (2018) explains that "you could just say let's keep it as it is, run it as Helvetic. But own it and integrate it better into your network." (Appendix 11.1.4) The challenge therein would be to ensure the support of such a strategy by the entire Helvetic staff.

8 The auction process as strategic option

The previous chapters have analyzed the European market in detail and have specifically outlined the strengths and weaknesses of small airlines. The evidence from this study therefore suggests the following:

1. Consolidation in Europe will continue, and it will pick up speed and scope
2. Small airlines will be faced with consolidation pressures sooner or later, as the competitive forces in Europe will further put further pressure on costs
3. The large players will grow even larger, as has been seen with Lufthansa and IAG. Very recent events such as the turmoil of Air France imply the happening of future mega-mergers

The findings from this study further substantiated the fact that, to increase their chances of survival and maximize the transaction revenue, small airlines should consider to proactively sell themselves. Hence, the following section outlines different possible scenarios small airlines are confronted with, the lessons learned from the Virgin America transaction, and finally key criteria and stumbling blocks identified by the author.

8.1 Consolidation scenarios of small airlines

As explained in chapters 2.2 and 5.2.2., the fragmented nature of the European aviation industry still offers small airlines some opportunities to continue to operate independently. Summarized, the author sees the following scenarios:

1. Continue niche operations independently: if there is a strategic niche, and there is sufficient demand for air travel, high customer buying power, and organic growth potential, the airline can continue operating independently for the foreseeable future

2. Join them: If the situation equals scenario 1, but the airline queries the long-term sustainability of its niche operations, already highly depends on others, questions scalability or growth potential, or foresees an increase in competition then it can join the large players by selling itself, or initially entering an alliance

3. Icarus: If there is not a real niche nor a real strategy, insufficient market size, inability to compete, and increasing pressure from consolidation then the airline will either fail or get taken over on the sole terms of the buyer

This study has shown that all these scenarios are possible. However, in terms of surviving as an airline brand and in the shareholder's interest to maximize transaction revenue, it can be beneficial to act as proposed in scenario 2, before market forces catch up.

8.2 Lessons learned from the Virgin America case

The acquisition of Virgin America through Alaska Air as presented under section 2.1.1 was a novelty in the airline industry, as it showed how an airline can strategically approach consolidation in a proactive manner. In hindsight, three specific lessons can be derived that are of interest for any airline attempting such a strategic maneuver:

1. The management of Virgin achieved an excellent transaction price. By proactively approaching interested buyers it bumped up the deal revenue to $2.6bn. According to Zhang (2016) this is almost double of what the airline was trading at. Virgin shareholders earned $75 per share. In the year preceding the transaction, the highest value amounted to $37 per share. Evidently, Alaska paid roughly $1bn in Goodwill.

2. Alaska Air did not pay this much premium because they had abundant cash and simply liked the Virgin executives. Rather, the seller's management knew what it was offering the buyer (Zhang, 2016), and it leveraged its position – as Trestl (2018) argued "You don't need to sell - you can sell." (Appendix 11.1.2)

3. The Virgin America brand did not survive the transaction. Though initially promised by Alaska Air management as elaborated under section 2.1.1, the last flight branded as Virgin America landed on April 25, 2018 (Dorsey, 2018). This means the objective to continue to operate as 'own' brand was not achieved by the deal.

8.3 Key criteria

Results from the Virgin America case empirically support that proactivity can yield a profit in an M&A transactions. Combined with the observations made in the trend analysis in chapter 5, the author also sees the possibility that in the European market, the chances to survive as a brand under the new owner are higher than in the US. So far, all large airline groups in Europe are pursuing a multi-brand strategy. Hence, the following are considered key criteria in the small airline's attempts to build a business case for a future auction.

8.3.1 Proactivity and foresight

Evaluating market trends is crucial for any business venture. Having said this, in the case of airline industry consolidation and the very distinct European market, small airlines must comprehensively understand where the industry is headed and comprehend as a matter of prudence whether their business model is sustainable in the long term. Rising oil prices, for example, constitute a classical example of a threat that must be reckoned with. This foresight, however, must extend beyond the usual market analysis as it then enables the management to consider to proactively move forward, as seen in the Virgin America transaction. This means that the peculiarities of the fragmented European market offer opportunities for small airlines, but proactivity is imperative in order to capture them. The inevitable, then, is that small airlines will face takeover in the future. Foresight lays the fundament that will help them to trim their operations and align their staff, and the proactivity will weaken the effect of perceived desperation and improve transaction value.

8.3.2 Internal efficiency and leverage of success factors

As small airlines cannot realize economies of scale, strengths within the value chain must be identified and leveraged in order to improve efficiency. Moreover, resources should be directed towards the key success factors as identified in chapter 7, namely the strategic niche, the organizational fit, and the staff. To enhance the attractiveness to the potential buyer, the small airline's management should monitor the KSFs, and analyze in detail as to what organizational benefit the buyer would gain by acquiring the airline.

8.3.3 Clean operational history

Some airlines get handed over from one investor to the next, funding the venture until operations are halted. The lack of strategy and unawareness of market forces does not favor a clean operational history, and thus will not be attractive for any buyer. Hence, KSFs cannot be leveraged to increase transaction value and the brand survival, as the prime argument of the buyer to depress the price will lie in the operational history. Having a superior product, providing a timely service, financial stability, and favorable cost structure is a key argument in the auction process, as it ensures the buyer that there will be no bad surprises and operations can smoothly be integrated.

8.4 Stumbling blocks

Given that the small airline's management concludes that an auction could be a strategic choice in the future, the following stumbling blocks may obstruct such intentions.

8.4.1 Alignment of the airline staff

As seen in chapters 6 and 7, the small airline's staff is a major success factor that can be leveraged in negotiations. However, failure to align the employees with the strategic intentions can dismantle this advantage. Extensive costs and efforts may have to be directed towards solving issues related to labor unions, lowering the impact of synergies gained from the transaction.

8.4.2 Inability to concede

Examples within the industry provide evidence that the inability to make concessions is a major stumbling block. This is connected to the aforementioned staff alignment; if the entire organization is not directed towards change, and the inevitability of market forces is not conveyed thoroughly, the firm will not be bought in one piece but rather split apart, and the brand will not survive. Carefully projected, this threatens the existence of not only Alitalia, but more recently now also Air France.

8.4.3 Lack of a raison d'être

A small airline without a reason to be will not survive consolidation, as there is no need for their services. The lack of a real strategy, as is the case with Skywork, ultimately results in an investor losing money until the airline gets sold to the next investor. Without some raison d'être, the airline cannot make valuable arguments towards a potential buyer, as it has nothing to offer; consequently, it cannot leverage any KSFs towards such a goal, and is therefore destined to disappear at some point.

8.4.4 Perceived desperation

The last stumbling block is that the seller is perceived as acting desperate, which impacts on the price. This can be avoided by leveraging the KSFs and presenting a solid business case. The proactivity mentioned above is therefore imperative as it indicates that the organization could potentially continue on its own, even if no buyer is found.

8.5 Closing remarks

The European aviation sector is moving forward on the consolidation curve. This thesis has shown where the market is headed, how competitive forces are at interplay, and where small airlines can draw imperative strengths and weaknesses from. Some threats are faced by all airlines, while others are more dangerous for the small players.

The recent times of higher profitability levels, high growth in demand, and lower oil prices has allowed some airlines to continue operations even though a real strategy was missing. As some of these factors have reached an industry peak, it is questionable that such carriers can survive an industry downturn. Consequently, if ill prepared, they will face severe threats to their business.

This thesis has shown that there are strategic ways forward, such as the proactive M&A auction. The fragmented European market and the different political entities will not allow a similar form of consolidation as has been observed in the US, which offers opportunities for smaller players to survive as a brand. However, the presented key criteria and their impact should be carefully considered and studied within the organization before moving forward.

9 Conclusions

9.1 Summary

The aim of this thesis was to provide the reader with a wider understanding of the nature of industry consolidation within the European aviation sector. A further objective was to clarify the strategic options for small airlines, and whether it could be beneficial for them to proactively sell themselves before facing a hostile takeover. Finally, the goal was to provide key criteria and stumbling blocks small airlines should be aware of before considering the auction as a possible way forward.

The first chapter provided specific information about the aim and objective of this thesis, before Chapter 2 introduced the nature of consolidation in the American and European markets, as well as the differences in the dynamics of industry consolidation. It showed how the American market has progressed to stage 3 on the consolidation curve, whereas the European sector is still more fragmented, and finds itself in stage 2 on the curve. Chapter 2 also introduced the Swiss market and the respective airlines used as examples throughout the thesis, before Chapter 3 gave a quick introduction to the M&A auction process. That is, several buyers concurrently hand in offers to buy a potential target.

Chapter 4 introduced the methodology used within the thesis, namely the market analysis and the respective tools used to conduct it. Furthermore, it presented the expert interview as the main research methodology and gave an overview of the selected interview partners.

The fifth chapter covered the trend analysis of the European aviation sector. It provided information about the profitability levels, the general trend, as well as the future developments concerning consolidation. The chapter concluded that industry profitability is stable but seems to have reached a peak. Further, it revealed that consolidation will pick up speed and scope, and that the business models of LCCs and Legacy carriers are converging and integrating. Lastly, the trend analysis proposed that chances of survival for small airlines are low, and that they will face consolidation pressure rather sooner than later.

Chapter 6 entailed the market analysis of the European aviation sector. It used Porter's model of the five forces to plot the competitive landscape as well as Porter's model of the generic value chain to identify key activities of small airlines. Moreover, the SWOT analysis was applied to extract internal and external factors that are of strategic importance for small airlines. The chapter provided evidence about the strong competition in the industry and showed how the forces are fueling consolidation. It also proved why small airlines cannot compete against the large players. The value chain and SWOT analysis identified key value chain factors, that can subsequently be turned into strengths and opportunities.

Chapter 7 drew from the previous conducted analysis' in Chapter 6 and elaborated on whether it could be beneficial for small airlines to proactively approach an M&A transaction. Using the five perspectives of Marks et al., the chapter then presented a list of three Key Success Factors an airline should leverage in such an approach, namely the strategic niche, the organizational fit, and its people and staff.

Chapter 8 combined the knowledge gained in the previous chapters to answer the research question. It presented a list of consolidation scenarios for small airlines and elaborated on the lessons learned from the Virgin America case and why they are important for this thesis. After stating that it could indeed be beneficial for small airlines to take a proactive approach towards consolidation, the chapter presented a list of key criteria and stumbling blocks, all of which should be addressed by the organization in order to increase its attractiveness for a potential buyer. The chapter concluded that due to the fragmented nature of the European industry, small airlines have a higher chance of surviving as a brand than their American counterparts.

9.2 Contribution

The findings of this thesis support the understanding of the current state of consolidation within the European aviation sector and provide information about what is to be expected by small airlines in the future. The thesis specifically shows where the strengths and opportunities lie for small airlines and where respective company resources should be directed to. It also provides a signal for small airlines about the threat of consolidation to their businesses and makes them question the sustainability of their niche.

This study also serves as a basis for further research and will help to establish new strategic ideas that could help smaller airlines in Europe to find a way to co-exist amongst the large industry players.

9.3 Limitations and further research

This thesis has several limitations. First and foremost, it only consulted experts from the Swiss market, and used mainly airlines from Switzerland as examples. To comprehend the full market trends, industry experts from other European countries should be questioned, as the individual countries still act as sovereign entities and are entitled put constraints on the aviation sector. This for example entails the careful study of the impact of state subsidies.

Second, the underlying processes behind the Virgin America case and the differences between the European and American markets could not be reconciled fully. Detailed analysis of the Virgin case, as well as legal requirements and differences would need to be examined to fully comprehend the procedure of an airline M&A auction. Moreover, no evidence was found of another, similar case within the aviation industry. Thus the representativeness of the Virgin America case must also be carefully considered. Herewith, researchers are advised to conduct wider investigations into success factors and best practices concerning airline auctions.

Third, there have been few academic studies on the possibility of an airline auction. To predict how the market in Europe would react, and if there is an actual interest for such a process, was beyond the scope of this thesis.

Further research in these areas is therefore recommended. Moreover, as explained under 9.2 the information gathered in this thesis should be used to conduct wider research as to what strategies small airlines in Europe can apply to survive. Having identified important key criteria and stumbling blocks, it would be interesting to see how a framework would help a small airline's management to build a solid business case for an auction.

10 Bibliography

Aerosuisse. (2005). Vademcum. Retrieved from http://www.aerosuiss e.ch /fil e s / a e r osuisse/PDF%20&%20Grafiken%20Deutsch/pdfVerbandsarbeit/Vademecum/Vademecum%202005%20d.pdf

Aerosuisse. (2017). Vademcum 2017. Retrieved from http://www.aerosuisse .ch/files/aerosuisse/PDF%20&%20Grafiken%20Deutsch/pdfVerbandsarbeit/Vademecum/Vademecum_2017_en.pdf

Agius, W. (2018, April 25). Interview by D. L. Egli [Transcribed in Appendix 11.1.3]. Bachelor Thesis by David Egli. Winterthur, Switzerland.

AirlineGeeks.com. (2016, January 17). Airline Metrics: Revenue Passenger Kilometers. Retrieved May 7, 2018, from https://airlinegeeks.com/2016/01/17/airline-metrics-revenue-passenger-kilometers/

AirlineGeeks.com, A. com. (2015, December 28). Airline Metrics: Available Seat Kilometers. Retrieved May 7, 2018, from https://airlinegeeks.com /2015/12/28/airline-metrics-available-seat-kilometers/

Albers, S., Koch, B., & Ruff, C. (2005). Strategic alliances between airlines and airports—theoretical assessment and practical evidence. *Journal of Air Transport Management*, *11*(2), 49–58. https://doi.org/10.1016/j.jairtraman.2004.08.001

Amadeo, K. (2018, April 11). How High Will Oil Prices Rise in 2018 and 2050? Retrieved April 20, 2018, from https://www.thebalance.com/oil-price-forecast-3306219

Assaf, A. G., & Josiassen, A. (2012). European vs. U.S. airlines: Performance comparison in a dynamic market. *Tourism Management*, *33*(2), 317–326. https://doi.org/10.1016/j.tourman.2011.03.012

Bell, G. G., & Rochford, L. (2016). Rediscovering SWOT's integrative nature: A new understanding of an old framework. *The International Journal of Management Education*, *14*(3), 310–326. https://doi.org/10.1016/j.ijme.2016.06.003

Björk, A. (2017, December). *Wrap-Up International Strategic Management.* Lecture presented at the ZHAW School of Management and Law, Module International Strategic Management, Winterthur, Switzerland. Retrieved from https://moodle.zhaw.ch/pluginfile.php/1464371/mod_resource/content/1/BSc_IM_ISM_WrapUpOnline.pdf

Böck, P. (2015). Monitoring der Wettbewerbsfähigkeit des Schweizer Luftverkehrs. Retrieved from http://www.aerosuisse.ch/files/aeros uisse/PDF%20&%20Grafiken%20Deutsch/pdfVerbandsarbeit/Studien/2015.03.17%20MonitoringStudie%20Wettbewerbsfaehigkeit%20des%20Schweizer%20Luftverkehrs.pdf

Branson, R. (2016, April 4). On Virgin America. Retrieved March 31, 2018, from https://www.virgin.com/richard-branson/virgin-america

Bryan, V., & Lawson, H. (2018, May 8). Explainer - Strikes and a departing CEO: Turmoil at Air France-KLM. *Reuters*. Retrieved May 16, 2018, from https:// www. reuters .com/article/us-air-france-klm-dispute-explainer/explainer-strikes-and-adepartin g-ceo-turmoil-at-air-france-klm-idUSKBN1I91ZM

Burghouwt, G., & de Wit, J. G. (2015). In the wake of liberalisation: long-term developments in the EU air transport market. *Transport Policy*, (43), 104–113. https://doi.org/doi:10.1016/j.tranpol.2015.05.006

Calder, S. (2017, March 28). Virgin America Brand "Reitred" by New Owner Alaska Airlines - Sir Richards Laments Its Loss. *The Independent*. Retrieved from https://www.independent.co.uk/travel/news-and-advice/virgin-america-alaska-airlines-brand-retire-sir-richard-branson-sold-flights-travel-a7653231.html

Chen, D. (2016, February 2). The auction process in M&A. Retrieved May 14, 2018, from https://www.deallawwire.com/2016/02/02/2934/

Christensen, C. (2016, February 12). Industry Consolidation & its Impact on Mergers & Acquisitions. Retrieved March 30, 2018, from https://investmentbank.com /industry-consolidation/

Deans, G. K., Kroeger, F., & Zeisel, S. (2002, December 1). The Consolidation Curve. Retrieved March 30, 2018, from https://hbr.org/2002/12/the-consolidation-curve

Dichter, A., Hahn, S., & Maxwell, D. (2016, September). Winter is coming: The future of European aviation and how to survive it. Retrieved April 1, 2018, from https://www.mckinsey.com/industries/travel-transport-and-logistics/ourinsights/ winter-is-coming-the-future-of-european-aviation-and-how-to-survive-it

Dobruszkes, F. (2009). Does liberalisation of air transport imply increasing competition? Lessons from the European case. *Transport Policy*, *16*(1), 29–39. https://doi.org/10.1016/j.tranpol.2009.02.007

Dorsey, B. (2018, April 25). What It Was Like on the Last Ever Virgin America Flight. Retrieved May 12, 2018, from https://thepointsguy.com/news/what-it-was-like-on-the-last-ever-virgin-america-flight/

Eiselin, S. (2017, July 20). Etihad und Ermotti verkaufen Schweizer Airline. *Tages Anzeiger*. Retrieved April 4, 2018, from //www.tagesanzeiger.ch/wirtschaft/unternehmen-und-konjunktur/etihad-und-ermotti-verkaufen-ihre-schweizer-fluggesellschaft/story/24673120

Enz, W. (2017, November 28). Darwin Airline verliert Starterlaubnis | NZZ. Retrieved April 8, 2018, from https://www.nzz.ch/wirtschaft/darwin-airline-verliert-starterlaubnis-ld.1333436

Enz, W. (2018, April 13). Interview by D. L. Egli [Transcribed in Appendix 11.1.1]. Bachelor Thesis by David Egli. Zurich, Switzerland.

Eurocontrol. (2005, January 5). Glossary for Flight Statistics & Forecasts. Retrieved from https://www.eurocontrol.int/sites/default/files/article/attachments/eurocontrol-glossary-for-flight-statistics-and-forecasts.pdf

Eurocontrol. (2016, December 23). What is a slot? Retrieved May 7, 2018, from http://www.eurocontrol.int/news/what-slot

Genter, J. T. (2017, October 21). Richard Branson Says Alaska Airlines "Castrated" Virgin America. Retrieved April 1, 2018, from https: //thepointsguy.com/2017/10/richard-branson-alaska-airlines-castrating-virgin/

Grundy, T. (2006). Rethinking and reinventing Michael Porter's five forces model. *Strategic Change*, *15*(5), 213–229. https://doi.org/10.1002/jsc.764

Hackett, R. (2016, April 4). Richard Branson Explains Why He's Selling Virgin America. Retrieved March 31, 2018, from http://fortune.com/2016/04/04/richard-branson-virgin-america/

Hammond, N. (2016, March 5). Have we reached the end of U.S. airline consolidation? Retrieved March 31, 2018, from http://www.goldspringconsulting.com /2016/05/03/have-we-reached-the-end-of-u-s-airline-consolidation/

Heffernan, M. (2012, April 24). Why mergers fail. Retrieved March 28, 2018, from https://www.cbsnews.com/news/why-mergers-fail/

Hethcock, B. (2017, April 6). Honey, I shrunk the airline industry — How mergers have driven consolidation of the airline industry. Retrieved March 31, 2018, from https://www.bizjournals.com/dallas/news/2017/04/06/how-mergers-have-driven-consolidation-of-the.html

IATA. (2017a, December). Economic Performance of the Airline Industry. Retrieved from http://www.iata.org/pressroom/facts_figures/Pages/index.aspx

IATA. (2017b, December 5). Strong Airline Profitability Continues in 2018. Retrieved March 31, 2018, from http://www.iata.org/pressroom/pr/Pages/2017-12-05-01.aspx

Ifediora, C. O., Idoko, O. R., & Nzekwe, J. (2014). Organization's stability and productivity: the role of SWOT analysis an acronym for strength, weakness, opportunities and threat. *International Journal of Innovative and Applied Research*, *2*(9), 23–32.

King, I. (2017, October 3). Why Monarch is the latest airline to go under - and more could follow. Retrieved March 23, 2018, from https://news.sky.com/story/why-monarch-is-the-latest-airline-to-go-under-and-more-could-follow-11064471

Kocic, A. (2017, September 26). Definition of Industry Consolidation. Retrieved March 30, 2018, from https://bizfluent.com/about-6555139-definition-industry-consolidation.html

Koenen, J. (2018, February 6). Overcapacity to propel airline industry downward in 2018. Retrieved April 20, 2018, from https://global.handelsblatt.com /companies/overcapacity-propel-airline-industry-downward-2018-883878

Kort, K. (2017, November 1). US airline consolidation serves as cautionary tale. Retrieved March 23, 2018, from https://global.handelsblatt.com/companies/us-airline-consolidation-serves-as-cautionary-tale-846627

Krutzler, T. (2018, April 25). Interview by D. L. Egli [Transcribed in Appendix 11.1.5]. Bachelor Thesis by David Egli. Altenrhein, Switzerland.

Marks, M. L., & Mirvis, P. H. (1998). *Joining forces: making one plus one equal three in mergers, acquisitions, and alliances*. San Francisco, Calif: Jossey-Bass Publishers.

Miles, J., & Gilbert, P. (2005). *A Handbook of Research Methods for Clinical and Health Psychology*. Oxford University Press.

MindTools. (n.d.). Porter's Value Chain: Understanding How Value is Created Within Organizations. Retrieved March 28, 2018, from http://www.mindtools.com /pages/article/newSTR_66.htm

Mott McDonald. (2017, March). EU Air Transport Industry Analyses Report 2016. Retrieved from https://ec.europa.eu/transport/sites/transport/files/2016 _eu_air_transport_industry_analyses_report.pdf

Mutzabaugh, B. (2015, October 15). Era of airline merger mania comes to a close with last US Airways flight. Retrieved March 31, 2018, from https://www.usatoday.com/story/travel/flights/todayinthesky/2015/10/15/airline-mergers-american-delta-united-southwest/73972928/

Narkhede, S. (2017, November 21). Has airline liquidity improved over the past four years? Retrieved May 11, 2018, from http://www.ishkaglobal.com /News/Article/5716/Has-airline-liquidity-improved-over-the-past-four-years

Nead, N. (n.d.). Three Types of Auctions for Sell-Side Mergers & Acquisitions | Investment Bank. Retrieved May 14, 2018, from https://investmentbank.com/merger-acquisition-auctions/

O' Dwyer, G. (2018, January 18). Global Finance Magazine - Europe To See More Airline M&A Activity, Consolidation, In 2018. Retrieved April 1, 2018, from https://www.gfmag.com/topics/western-europe/europe-see-more-aviation-sector-m-consolidation-2018

OAG. (2015, April 12). Routes Europe Briefing. Retrieved from http://www.oag.com /hubfs/Presentations/john-grant-routes-europe-2015briefing.pdf?hsCtaTracking= 31f85394-bb09-4cbf-9c66-5a60164840de%7C739ba2ee-3a5f-42dd-beec35c37 9464742

Patterson, T. (2015, October 15). US Airways' last flight evokes "golden age." Retrieved March 31, 2018, from https://www.cnn.com/travel/article/us-airways-last-flight-american-airlines-merger-feat/index.html

Pickton, D. W., & Wright, S. (1998). What's swot in strategic analysis? *Strategic Change*, *7*(2), 101–109. https://doi.org/10.1002/(SICI)1099-1697(199803/04)7:2<101:: AID-JSC332>3.0.CO;2-6

Porter, M. E. (1985). *Competitive advantage: creating and sustaining superior performance. 1985*. New York: Free Press.

Porter, M. E. (1998). *Competitive strategy: techniques for analyzing industries and competitors: with a new introduction* (1st Free Press ed). New York: Free Press.

Porter, M. E. (2008). The Five Competitive Forces That Shape Strategy. *HBR*, 23–41.

Porter, M. E., & Millar, V. E. (1985). How Information Gives You Competitive Advantage, 24.

Powley, T. (2017, October 8). European airlines face more cuts and consolidation. Retrieved March 31, 2018, from https://www.ft.com/content/b2b79a6e-a9f9-11e7-93c5-648314d2c72c

PwC. (2017). Tailwinds 2017: airline industry trends. Retrieved April 11, 2018, from https://www.pwc.com/us/en/industries/industrial-products/library/2017-tailwinds -airline-industry-trends.html

Robert Wood Johnson Foundation. (2008). RWJF - Qualitative Research Guidelines Project, Semi-structured Interviews. Retrieved May 15, 2018, from http://www.qualres.org/HomeSemi-3629.html

Robertson, E. (2017, September 24). European airline consolidation expected. Retrieved March 23, 2018, from https://www.routesonline.com/news/29/breaking-news/274947/european-airline-consolidation-expected/

Schmid, A., & Flottau, J. (2017, October 30). Fluggesellschaften in Turbulenzen. *Tages Anzeiger*. Retrieved April 4, 2018, from //www.tagesanzeiger.ch/wirtschaft/ standardfluggesellschaften-in-turbulenzen/story/23356659

Shen, L. (2016, March 23). This is Why Shares of Virgin America are Popping Today. Retrieved March 31, 2018, from http://fortune.com/2016/03/23/virgin-america-sale/

Statista. (2018). U.S. airline industry market share 2017. Retrieved March 31, 2018, from https://www.statista.com/statistics/250577/domestic-market-share-of-leading-us-airlines/

Swoboda, M. (2016, July 20). What is ACMI leasing? Retrieved May 7, 2018, from http://airlinebasics.com/what-is-acmi-leasing/

Trestl, M. (2018, April 18). Interview by D. L. Egli [Transcribed in Appendix 11.1.2]. Bachelor Thesis by David Egli. Kloten, Switzerland.

Unnikrishnan, M. (2016, June 2). Further Consolidation Could Result In Fifth Major U.S. Carrier. Retrieved March 31, 2018, from http://aviationweek.com/iata-agm-2016/further-consolidation-could-result-fifth-major-us-carrier

Wittmer, A. (2018, April 25). Interview by D. L. Egli [Transcribed in Appendix 11.1.4]. Bachelor Thesis by David Egli. St. Gallen, Switzerland.

Yellin, T. (n.d.). The runway to the final four. Retrieved March 23, 2018, from http://money.cnn.com/infographic/news/companies/airline-merger/

Yılmaz, Y., & Bititci, U. S. (2006). Performance measurement in tourism: a value chain model. *International Journal of Contemporary Hospitality Management*, *18*(4), 341–349. https://doi.org/10.1108/09596110610665348

Zhang, B. (2016, April 4). Alaska Airlines just massively overpaid for Virgin America, and it’s a deceptively smart move. Retrieved May 12, 2018, from http://www.businessinsider.com/alaska-airlines-overpaid-virgin-america-worth-it-2016-4

11 Appendix

11.1 Transcribed Interviews

11.1.1 Werner Enz, Editor, Neue Zürcher Zeitung NZZ

Transcript: Interview with Werner Enz, editor and aviation journalist at NZZ

Interviewer:	David Egli, Student IM
Interview partner:	Werner Enz
	Editor, Aviation journalist, NZZ
Date:	Friday, April 13th, 2018
Time and Location:	14:30
	Falkenstrasse 11, Zurich
Language:	Swiss dialect (de)

Interviewer: What do you think about small airlines in Europe? What are their advantages/opportunities and disadvantages/threats? Some scholars say SWISS would be a middle sized Airline, so as an example I would take something smaller than SWISS, for example Helvetic Airways.

Werner Enz: Yes, Helvetic is very small. All in all, they have about 400 employees since they also handle the maintenance part. So yes, what should I say about those small airlines - what is special in this industry compared with banks or insurance companies is that the market entry barrier is relatively low. If someone has a little money and thinks this is interesting, he can get a permission with 2 or 3 planes, show his business plan and just start at some point.

In Europe, roughly said, we have for sure more than 100 airlines. But those that really count are maybe 20 or so. Helvetic Airways was built up by Mr. Ebner piece by piece with the strategy of a niche player, constantly checking the 'bigger concert', and offering flight services from Switzerland. So this means obviously they don't service a speedway like Berlin or Madrid with their Fokker that sits roughly 100 people. A) they rather offer tactical services such as servicing certain holiday destinations like south Italy and B) they've been maintaining important wet-lease contracts for years, also acting as a capacity modulator for SWISS. Skywork Airlines then would be even smaller yet, with their home base Berne - a hard business with even smaller airplanes, and Berne also isn't the center of the world. And to be honest, the distances within Switzerland are getting smaller and smaller, also with the increase in quality of the public transportation system. So to take the car or train to Basel or Zurich and then fly from there is more convenient for most. In maybe a radius of 300-400 km the railway is often the better way of transportation.

Interviewer: So what would you then say could be a specific advantage of small airlines, or let's say Helvetic. I mean they have managed to stay around for a couple years now, so they kind of have their raison d'être, wouldn't you say?

Werner Enz: So one advantage could be that they are maybe more flexible in adapting certain flight plans. If you are SWISS you are maybe more exposed to the customer's expectations that you always offer that flight to Kiev, whilst as a small carrier you may adjust your schedules more often. Apart from that you also have the strong company spirit as often seen within small firms, one knows each other, decision paths are shorter, and everyone is more involved. In turn what has become difficult in Europe, as a small carrier you can't serve very lucrative routes as there is lots of competition - rather one serves a niche, making sure to not disturb the big ones. This way one can follow sort of an adjusted strategy. Or one serves a completely different segment, such as the business aviation. Here or there you might be able to establish something new if you have the right market feeling for it, maybe also in cooperation with the airport authorities in the destination country. Another trend is that the point-to-point connections are getting more important, the so called 'city pairs'. So suddenly there's someone who says „*Ok I'm just going to do it now*" - like right now, after the Air berlin failure, is the supply side really optimal? So for example Berlin-London offers chances, also for small players.

Interviewer: In the US, the last 15 years have seen immense consolidation. How would you describe the European aviation industry trend in general? Specifically, the big challenges for small airlines?

Werner Enz: If you think about what Lufthansa has bought in the last 10 years, it's enormous. Austrian Airlines, Brussels Airlines, Swiss, parts of Air berlin - and it can be generally observed that the top dog in a country eats the small ones. Here and there, there have been strategically courageous moves such as Air France-KLM, or the idea of British Airways to acquire Iberia plus Vueling, despite their strong London hub and north-Atlantic position. So for me within the IAG it is de facto still BA at the controls. Consolidation in general is not as far advanced in Europe as in the US, but it will continue. Another factor still observable is the continuing increase of LCC market share within the European market. And I would venture to say the Legacy carriers have underestimated this. The fact how easy you can win customers with a cheap machinery such as Ryanair is unbelievable. Plus, the European airline industry still experiences growth.

Interviewer: So this is a challenge for a small airline, as it basically gets eaten sooner or later. Or how would you interpret this, from the point of view of Helvetic or Air Baltic, also not a very big player.

Werner Enz: Well that also depends on who's behind it, and if they are seeking new investors. So if you think about it, there's been a time when Ryanair was really small, or when Wizz Air was really small, and they sometimes grow extremely fast. If their product is well received, they are like a wheel where everything just works, and that wheel gets bigger from year to year. So this means there are some small carriers doing their homework quite well, and they grow. Then there are some small ones that disappear again, or get liquidated, and the big ones inherit the parts. Then there's some without a growth strategy, and without special ambitions to gain market share but the goal to stay small and serve a niche segment. So for a Helvetic Airways in the current setup, with the current owner structure, this means there won't be big changes unless they get investors on board with higher aspirations. They will stay in the Swiss market, strategically operating in the shadow of SWISS, maintaining their close contracts with SWISS. The share of wet-lease orders from SWISS on Helvetic's capacity is very high, more than 50 percent. So these contracts aren't changed overnight, and if something is abandoned then it's usually for a longer period. And SWISS also has other 'wild cards' in store, through the Lufthansa Group. What we have seen in recent years is that Edelweiss as brand has been pushed extremely, and that it plays and important role in the Lufthansa calculations by serving important travel destinations here and there. This is also due to the fact that for example Belair has financially crashed. Now Belair is gone, the Arab investors are gone, as you might remember how one tried to stir up the market with Etihad Regional. For Darwin it was not at all beneficial to sell stakes to the Abu Dhabi investor, who, from my point of view, made large strategic mistakes by investing in Alitalia and Airberlin.

Interviewer: In your opinion, how do you think consolidation in Europe differs from the US?

Werner Enz: In Europe consolidation is not as far advanced. And even though we have a European Single Market concept - if I have my HQ in Vienna I can practically fly anywhere - there's also quite some protectionism. So if you are Etihad, liked or not, you cannot buy an entire European airline. Then it basically loses the intra-European freedoms. So in net terms the European aviation market constellation is neither very witty, nor innovative, nor liberal. I mean neither are the Americans, as it is forbidden as a foreigner to hold more than 25 percent of a company's shares. So also very nailed up concerning ownership structures.

Interviewer: Yet there we see that Delta buys another airline and it all becomes Delta, whereas here, Lufthansa buys Swiss and Swiss is still Swiss.

Werner Enz: In contrast, the US is 'one big nation', whereas in Europe, Union or not, what prevails is still the societal image of individual nations. And it would for sure be a strategic mistake of the highest order if you would just erase the brand SWISS, and say „*well you know dear colleagues, as you know we have bought this 13 years ago, it's about time and we're going to restyle everything, and it all becomes Lufthansa.*" The brand Lufthansa is so far ok in Switzerland, but one would simply be giving up market opportunities if one would abandon the brand SWISS. The emotionality in the aviation business should not be underestimated. On the other hand, if you go and check how many airlines still carry the national flag on their tail - there aren't that many anymore. Then there's those who aren't that proud of it anymore, for example Alitalia. Just recently it was announced that the selling process was prolonged because the state now faces the problem that Alitalia is under state receivership. But the markets are moving fast and if under European freedoms I can fly to Rome or Bergamo, why should I buy stakes of Alitalia, that wouldn't make sense. About half a year ago I wrote an article reading

„*Ryanair makes Alitalia obsolete.*“ Alitalia is not needed, and if you would turn it off from one day to another, it would be horrible for the employees etc. but concerning the service quality, you would find a situation not very different from today within a few weeks. Here and there we see rescue maneuvers by governments that don't necessarily concentrate on the quality of certain services, but simply on protecting jobs.
I am awed every once in a while, as the EU always talks about the prohibition of state subsidies, but why then was it ok with Olympic Airways, or now Alitalia? I mean, they get supported with hundreds of millions of Euros again and again - where's the business case, where's the liquidation plan? Nowhere. And that makes the European market supervising body vulnerable. And as long as Rome doesn't comply, what are you going to do, really.

Interviewer: Considering Porter's five forces – Industry Competitiveness, Threat of New Entrants, Power of Buyers, Power of Suppliers, Threat of Substitutes – how do you perceive these forces at work within the European market?

Werner Enz: Industry Competitiveness: Everything is more or less 'regional' within Europe. And you basically have no gadgets anymore, so you have a very homogenous product, i.e. flights from A to B. Maybe you have a checked luggage, but the sandwich you can basically bring yourself. So in terms of on-board service, you have some sort of commodity. In the industry competitiveness, connectivity is very important, so the quality of the routes you serve, and what recurring cost structure you have, since that is very crucial to remain competitive. It also depends on the routes, some are frequently used by business travelers, others are pure holiday destinations with very price sensitive customers. For this reason, there can be airlines you wouldn't expect operating very strongly on some routes. But overall, Ryanair is definitely number one for me at the moment. They are mainly so successful because the model is so simple - lean, identical fleet, short rotations. Threat of New Entrants: For me that's not a threat but rather an opportunity, since entry barriers are low, compared to other industries. And it is apparently also sexy to be part of this aviation-machine. There's a billionaire here and there who wants a landmark. Niki Lauda for example just can't stop, he's still in the business. First negotiating with Lufthansa, then IAG, and then all of a sudden with Ryanair. Or if you consider Olympic Air, back in the day one of the worst led airlines, now operating profitably and growing under the new name Aegean. In general, since I've been writing about this, mobility together with increased income levels is still growing. There's not really a feeling of market saturation. And I also haven't seen a very strong substitution thus far. It's not as if we would be saying the route Switzerland-France is totally old and unattractive for airlines. Overall seen there's a lot of market potential in this area. Power of Buyers: Ryanair has something around 100m passengers a year, Lufthansa as well, though that's consolidated over the group. So an average Ryanair flight maybe around 1800km while with Lufthansa it might be something around 4000km. And it will be interesting to see if this multi-brand strategy of Lufthansa works out, with Eurowings as a counter action. They have grown very fast in the last two years, which shows that within the Lufthansa group one can work out a different cost structure, focused on low-cost point-to-point routes. Power of Suppliers: That really depends on the kind of service. So in terms of ground handling, Swissport is a very strong player.

Interviewer: So would you also see the possibility of backward integration? So Lufthansa or Swiss say ok, we're going to buy Swissport back?

Werner Enz: Yes, for sure. I'm a strong believer in the concept that there are more favorable shareholders for some firms than others. So if a main carrier or a shareholder can't make use of something other than ruin or drain it, sooner or later there the question of 'what now' will arise. Lufthansa for example is very diversified: own catering and own maintenance, which is also strategically important. In contrast, there are many airlines who are glad that there are 'independent' firms such as SR Technics.

Interviewer: Lufthansa and Co. have so far renounced to incorporate acquired airlines, but rather form large groups and let the subsidiaries operate under their own brand. This differs from the approach of US airlines, forming massive carriers under a single brand - do you think this European 'fragmentation' provides opportunities for small airlines?

Werner Enz: Well that doesn't just depend on the brand, but is also due to the fact that for example Lufthansa doesn't have a very strong home market - here one speaks of a so called 'catchment area'. An example would be Cathay Pacific in Hong Kong. This means with the natural stream of customers from that area (large city, metropolitan area) you can already achieve a lot. This is definitely not the case for Lufthansa. Neither Frankfurt nor Berlin are that large. So a multi-hub strategy seems to be the natural result. And that is what they are doing - basically a sub-hubbing in Munich, Vienna, and Zurich. So then it seems perfectly fitting to have an own brand for each market. You also have to keep the customer's emotional attachment in mind - America is different, they don't have the need of a 'Nebraska' or 'Wyoming' airline. It's not the same perception of state belonging. And I see this as something that continues, though it probably won't last forever. For example, AXA buying Winterthur insurance - first one kept the orange in the logo, then it became blue, and in a couple of years AXA Winterthur in Switzerland will simply be AXA. From this process I would not exclude airlines explicitly, but for sure for a couple of years, and many years in Switzerland. In Switzerland there are also ties to the old aviation foundation through which also the Swiss government brings itself into play and postulates that the Swiss economy has the need of intercontinental connections. Also you still have the system of bilateral agreements based on the Chicago convention of 1944. This means also a Lufthansa has to come to an agreement with the Swiss government.

Interviewer: Are you familiar with the Virgin America case?

Werner Enz: So Virgin stands for Branson, right? I mean he's a very successful billionaire, with his brands Virgin Atlantic, Virgin Australia and then also Virgin America. As far as I know they've been bought by Alaska Air roughly 2 years ago and are following sort of a niche strategy within a certain geographical area, that is US west coast.

Interviewer: In light of industry consolidation, do you think it could be beneficial for small airlines to sell themselves on their own terms (before getting taken over or being pushed out by competition), and if so, why? What could be possible advantages / disadvantages?

Werner Enz: So the way you are framing this basically describes the case of SWISS. Basically on the ruins of a grounded airline, and in a combined effort of state and private firms, one operated a at the beginning very large fleet. And after struggling to survive they were thinking, well, how can we solve this. I mean, Nestlé, Swiss Re, the two big banks, some other private Companies, and most of all the Swiss state, they all jumped in with the idea to establish a new base. And then the markets showed that if you want to become attractive you have to do your homework. So that meant to strongly reduce the fleet, depreciate some assets, and negotiate on a new basis. So in a not very golden situation one finally had a business case and sold the airline to Lufthansa.

Interviewer: But one also has to say that SWISS was acquired very cheaply, and didn't have a lot of arguments left - so basically the airline was on the ground, and not in a very favorable position to negotiate.

Werner Enz: 2003/2004/2005 I have experienced it all, it was a difficult situation, the company was losing tons of cash. At the beginning they started of with what, CHF 3-4bn? And because everything was on the ground it was all very lean, good conditions with the leasing contracts, and everything on the left and right was basically gone. But still it didn't work. But the price really wasn't one of the three most important aspects back then. More important was to find someone from the industry with experience and the willingness to take on the risk, I mean you couldn't sell the airline to the baker from next town. Secondly one needed someone who opened the door to the marketing alliance, one of the three big ones. Those were mainly the deciding factors.

Interviewer: So to maybe specify, I mean SWISS wasn't a very healthy company by the time they were sold. What I'm more interested in is if I'm a small, healthy airline with a good product, could it also be a strategic option to sell now instead of wait until consolidation forces me to?

Werner Enz: Yes, I mean SWISS was relatively large after it had been rebuilt, and it was also a direct competitor of Lufthansa. And Lufthansa didn't have the urge to hand out presents at all. So a small one here or there, like Helvetic Airways, it's the owner who has to think about how to further develop his company in the future. And one option, like you say, is always to look for a stronger partner. And then it might also not be that important if the brand survives for a couple decades or not.

Interviewer: So then if you look at Air Berlin, I mean this gets ripped apart now and divided by the different buyers, and the Air Berlin brand is gone forever. Or Virgin America, where everyone was happy at first that the brand would continue to exist, and now everything will disappear anyway.

Werner Enz: Well it always depends on the circumstances of the acquisition or merger of equals. But I mean if you can't progress strategically and you are 10 times smaller than the one who buys you, you also shouldn't be too naive. And this is always the case, the one who buys the risk makes the decisions. I mean who else.

Interviewer: Marks and Mirvis (2010) defined five overlapping perspectives in M&A transactions. Considering a small airline that wants to sell itself, where would you see

1) Key arguments/possibilities for small airlines
2) Key Success Factors (KSFs)
3) Stumbling blocks

Werner Enz: So if I want to sell despite having a healthy organization, it's basically admitting that someone is stronger or better. This also means I actively give up control. To sell means to give up the claim to create. So a small firm that is sold, it's interesting from a management perspective. In small firms often the management members hold large stakes in the company. So there would be the option of management buyout or one finds a good partner. The result are chances to grow with the new setup, and it also makes a good story for the employees, and if it's all about repositioning or growing internationally, it might be that two small ones get together. The guy from Lufthansa it talked to at the IATA conference last summer said it quite bluntly from my perspective. He said „*Look, the European market is extremely fragmented, we are far behind the Americans. Of course we see that Airberlin has problems, but do we have to buy an entire airline or do we just need new planes? Planes which we can acquire much cheaper this way than if we buy them from airbus directly.*“

And then there's something completely different adding to this, if you look at Alitalia, they aren't interested in the company or the employees, but in the Italian customers. This is the important aspect, and you always have to make sure not to lose the focus in this. From my point of view, Alitalia cannot be integrated. It's been tried many times, for example by Air France more than 10 years ago, and they all failed. And the markets move extremely fast - if I'm not mistaken, Ryanair is much bigger than Alitalia in operating flights from and to Italy. Ironically their largest airbase is neither Rome nor Milano, but Bergamo.

Interviewer: Probably we can say that Alitalia as a whole cannot be integrated, as it is too late for them. But if I am a smaller Airline and I want to be integrated, then I can direct resources accordingly and prepare myself - or would you say that is utopian?

Werner Enz: I think yes. If you hear what Qatar is doing with Meridiana Airlines in Olbia, second largest airline in Italy. So if anything happens it's about me, calling the minister of transportation and telling him „*Dear minister, you have a problem and I can help you. But you have to give me the bilateral freedoms from and to Italy*." But then it has to be a setup with a majority of the shares lying with a European investor. So this is how this works, or how I would expect it to happen. And every second there are tickets sold, decisions taken, and the markets shift - for example in Cargo Alitalia is number 8 in Italy. That means there are 7 airlines ahead of it, delivering more cargo than them.

Interviewer: So yes again, Alitalia is kind of a dead horse. But if we look back at Virgin, I mean they had good arguments. They went to Alaska and said well, we are strong on the west coast and you want to be stronger positioned here, so we have a good match.

Werner Enz: Well as far as I understand they are kind of in trouble now, with the brand disappearing. And if I pay 2.3bn dollars for a company, and we talked about this branding issue, if I can build a strong case with Alaska Air then that is cheaper in many aspects than pursuing a multi-branding strategy. If we look at Europe, I mean it's different. The name IBERIA for example still exists. That's also because the name above really doesn't mean anything - IAG, you cannot use this for marketing purposes. Doesn't make sense, I mean it's lacking depth - so it's purely functional.

11.1.2 Dr. Michael Trestl, SWISS International Air Lines Ltd.

Transcript: Interview with Michael Trestl, Senior Director and Head of Business Development, SWISS International Air Lines Ltd.

Interviewer:	David Egli, Student IM
Interview partner:	Dr. Michael Trestl Senior Director Head of Business Development & Executive Office SWISS International Air Lines Ltd.
Date:	Wednesday, April 18th, 2018
Time and Location:	11:00 Obstgartenstrasse, Zurich
Language:	en

Interviewer: What do you think about small airlines in Europe? What are their advantages/opportunities and disadvantages/threats?

Michael Trestl: I think it very much depends on how you define small because if you compare on like on a global competitive scale even SWISS would be a rather small player in the market. But in Europe there are a number of smaller airlines which are focusing more or less on specific niche markets, be it more on a regional scale, like, you mentioned the example of Helvetic which is I would say is a very rare example of how an airline can exist because they have specialized fully, more or less fully on providing wet-lease services to other airlines, especially to SWISS. So their own sort of commercial responsibility is there but it is very limited. I mean of course you have to negotiate from a Helvetic perspective the long-term wet-lease contracts with your partners, but you are not exposed to those kinds of market risks like for instance SWISS would be, for selling tickets directly on the market. And so I see, you know, if we compare or if you take the example of Helvetic. I mean there are other examples in Europe, in France and there are other examples also in Great Britain with smaller airlines that are really specialized in their market niche, or regional routes. Some have even specialized in serving just one or two routes with a high degree of commuting traffic - take the example of Altenrhein's Viennaline, with I think only 2 aircraft serving only a handful of markets, which gives a high degree of specialization. So this is I would say one of the advantages that exists in regards to those small airlines, having a high degree of specialization which means a high customer orientation, and also a high degree of vertical range (Fertigungstiefe) to a certain extent - the degree of how deep you really know your special market or segment that you particularly take care of. With those advantages definitely come speed to market and flexibility. So speed I would say is one of the big advantages. And also one advantage before we come to the disadvantages, without knowing those regional and smaller airlines in every detail, but from what we know and what we understand from the situation is that very often the cost structures are very favorable in terms of regulation, so very little regulation given by unions or labor regulation. Which again contributes to the dimension of flexibility. On the other hand, the disadvantages I would see in purchasing. So if such a small airline wants to purchase an aircraft you are more or less really then alone on the market, so you are not able to leverage on any purchasing synergies which you might have as part of a bigger group or as a bigger airline. So purchasing power of you as an airline is rather low. Same with the bargaining power which you have with your suppliers. There is very little leverage that you have through economies of scale because you are small.

Interviewer: How about the chances of survival for small airlines in Europe/Switzerland such as Skywork and Helvetic? Are they even needed?

Michael Trestl: It's difficult to predict the future of course, nobody knows you know what is happening the day after tomorrow - tomorrow we even don't know but we tend to know a little bit better than for the day after tomorrow. But I mean especially those examples which you list here, like for instance Skywork, is one example where we have just recently seen the thin line between success or failure. I think in general the European market tends to consolidate, so we see this - I don't want to say it's a mega trend - but it is a certain trend or at least a tendency towards consolidation and towards those rather small airlines becoming part of a bigger group of airlines. Nevertheless, I believe certain niches will remain on the market which will also provide a solid ground for the very small airlines, the Skywork or Helvetic of this world, also to survive in their particular niches. But you have to ask the question of the scalability and of the future perspective if at a certain point you realize there's no growth option. Or if you are also exposed to certain risk associated to only one aspect. For example, Helvetic - and this is just a hypothetical sentence which I am now saying - but if SWISS would come to the conclusion to end the contract with Helvetic there would be a very low probability of survival, probably. In this dimension of today.

Interviewer: Helvetic is very dependent on those contracts with SWISS, too. That's what you are saying, no?

Michael Trestl: It is a consequence of Helvetic's business model, which is to provide wet-lease services to other airlines, to be dependent - more or less - on other market players. It's like if you are selling milk as a farmer and you are only selling it to one supermarket and if the supermarket today or tomorrow decides to buy from another farmer, then either you find another supermarket or you….(chuckles).

Interviewer: SWISS belongs to the Lufthansa Group that owns a significant number of airlines. Is SWISS itself interested in buying other airlines? What could be possible reasons to do so?

Michael Trestl: I think there are two dimensions to this. The first dimension is indeed, as you say, that SWISS is an integral part of the Lufthansa group and as such also part of the creation of something new, in the name of the Lufthansa group. So we are more or less deep involved in those M&A transactions which are currently on the table, like Air Berlin was last year and maybe others will come this year or next year. We are involved and in the end of the day SWISS can also benefit from these transactions. The second dimension, you are asking if SWISS itself is looking for M&A deals on the market and I have to say that we are observing and constantly monitoring, but we don't have such an appetite to go on a purchasing tour. We rather more or less contribute to this overall consolidation which is driven by the group. But in particular for us, as we are the responsible airline for the market Switzerland within the Lufthansa group, we are very much monitoring of course what is going on here in our local market, and especially in those partnerships which we have mentioned before - would SWISS be interested in buying Helvetic, you know these questions come up on a periodical basis but there is also not real interest in it at the moment. So to answer what could be possible reasons to do so, to enhance the cost structure or to enhance market presence, or to better tap a certain customer or market segment. To give one example, in 2008/2009 - there was indeed kind of a local M&A transaction - when SWISS as the driving force, but in the end also Lufthansa group, decided to buy Edelweiss from Kuoni. Why, because it was a favorable cost structure, it was also enabling SWISS and with SWISS the Lufthansa group to tap into the leisure segment here in Switzerland with an already existing customer base.

Interviewer: Considering Porter's five forces – Industry Competitiveness, Threat of New Entrants, Power of Buyers, Power of Suppliers, Threat of Substitutes – how do you perceive these forces at work in Europe?

Michael Trestl: So industry competitiveness as first one is still on a high level even though the consolidation is going forward. There is still a very fragmented landscape of countries in Europe and with this a fragmentation of airlines. Still we have a very strong country specific culture, like France and so on which are rather small markets if you compare with the US, you know, a huge market, 'all is one' so to say - in Europe we don't have this structure. Which also leads to the fact that the number of airlines which are active on the market is rather high. The threat of new entrants I would say it has gone down a little bit, I think the new entrant phase in the market has reached its peak. Still there are smaller players coming up, like we also see now with the transaction of Air Berlin which then went into Lauda Motion when he bough back his shares from Niki and then again went into partnership with one of the big player, which in this case was Ryanair. So I would say here is a certain threat of new entrants of course, on the one hand it's also a little bit complicated to open up a new airline because you have to adhere to all these safety standards and regulations and have a fast bureaucracy involve. On the other hand it's nothing which is not feasible to do. You just need to hire people who know the industry and then you can set up your airline basically. I would rather see what could be a threat for such new entrants is the infrastructure constraints, because even though if today someone came up with the idea to open up a new airline and to operate here in Zurich the he or she would very quickly come to the conclusion that there are only very few additional slots available, there are infrastructure constraints, and there are all kinds of difficulties on a political level which erode the attractiveness of doing so. The power of buyers it is also still high, I think if you consider the customer as a buyer, it's getting more and more intense to cope with those future customer needs. With new technology, with e-commerce, everything has become so transparent. Nobody is going into a travel agency anymore to buy a plane ticket only. So you have full price transparency on the internet and you also have full customer satisfaction transparency through all these portals which rate the airlines according to their quality and customer satisfaction. So power of buyers is definitely very high. Power of Suppliers is also high but we have to differentiate between those suppliers which supply infrastructure - there I would say it is high, because very often they are in monopolistic situations like there's only one airport here in Zurich, so you have to take what this airport is offering. So more or less you have to take what you get. Of course you can negotiate and try to get better deals, but if you are in a monopolistic situation, it's very difficult. The threat of substitutes I think is a very interesting point if we are thinking about innovative and new modes of transportation. So innovation, digitalization in mobility. For example, today getting from A to B, to get on an airplane is the most convenient and time saving way of traveling. But if you think for example of autonomous transportation - if you go down 10, 15 years down the road, especially for those kind of smaller airlines focusing on regional routes, you could ask if it's more practical and also more efficient for someone to take a self-driving vehicle to go from Zurich to Geneva or to Lugano. And use the time to work, or sleep, or do whatever you want in that new form of transportation. So I would say with new technologies and all these kind of evolving business models and innovations and also digitalization in the field of transportation and mobility, threat of substitutes is increasing. However, still we have to say that for long haul flights there was this kind of threat and everybody said with the introduction of video-conferenceing capabilities, nobody will go on a business trip anymore - but this threat has not materialized. Because we still see a lot of people going on business trips, since the personal interaction is still more important. But of course I mean also in that way, if you go down the road five, ten, fifteen years you can meet in person through holograms, more or less without you as a person having to physically travel anywhere. With virtual reality and augmented reality and all kind of things which could come up, it could also be a threat of substitution.

Interviewer: Is flying a commodity nowadays, and are Legacy carriers becoming LCCs?

Michael Trestl: It's a tricky question to answer because we as SWISS as a premium positioned airline definitely try to differentiate ourselves from the competition through premium product propositions. For example, more legroom, we still have a business class on European flights, we still offer full service F&B concept - even though in Geneva we are now trying something new, but which is also no low cost product, with the high quality premium partner which we have down there. On the one hand yes, the two business models Legacy and LCC, point-to-point airlines are coming towards each other more and more, but also maybe there is a tendency that the Legacy airlines are adopting some elements from the low costers. Vice versa the same effect happens. If you think of Ryanair for example five years ago, no one thought about the customer. It was all about the revenue, and efficiency, and about time, and nobody really cared how the customer feels and where can a customer complain, and so on. But recently the strategy has changed as well. Even though they are offering a low cost product they have adopted the philosophy of customer care which in former times was only to be found within the Legacy airlines. So it's coming together but I would not say that it has yet come to the stage where flying is a commodity. I would say if you want to see where it's really a commodity you would need to go to the US, because there it has really eroded and everything is more or less the same. But also there, if you think of market players as for example Jet Blue, who want to differentiate themselves also have quite a success in the market. So maybe we also see more or less a life cycle, everything more or less coming together, consolidating and consolidating, getting more and more homogeneous, but once it has reached this stage of 'commoditization' it spreads again.

Interviewer: What do you think about the impact of consolidation on:

a. Efficiency in terms of margins
b. Prices
c. Diversity of choice

Michael Trestl: Lets start from the back, diversity of choice: even though with ongoing consolidation, diversity of choice remains. Because there are the big markets which we have in Europe, and there is the demand in those markets, so I would say the diversity of choice remains. And even though if we look back 12-14 months, a lot of media coverage happened, especially in regards to the acquisition of Air Berlin throgh Lufthansa in Germany, with the intra-German market. Is competition eroding, and is the evil big

Lufthansa taking over an ‘milking‘ the whole market and so on. On the one side we have to be very self-critical, we have to say that on certain routes there have monopolistic situation arisen. On the other hand, the market capacity has not gone down, right the opposite happened. It has increased because even though this one transaction happened and consolidation went forth, at the same time competition also increased. Because they weren’t just looking what somebody is doing, so all of a sudden placed 10 aircraft or whatever in Berlin and started to operate, so this has led to the effect that even though this media coverage was there, if we look at our figures, prices continued to go down. So it was not the effect, from empirical evidence, based on our pure numbers and figures, that through the consolidation in the particular example of this transaction last year, the purchase of Air Berlin, that all of a sudden prices have exploded. Yes, there were some particular points where also in the cause of this transaction, in the first weeks and months the whole systems had to adopt and adjust to the new situation. And some situations have occurred, but this was not structural but more a particular situation which was picked up by the media and pushed forward. But the general trend in this particular case was and is favorable for the customer. So how can airlines then benefit from the consolidation if we are not like milking the customer? Getting bigger means we can use more economies of scale, we can use more of the cost regression - these are the impacts which lead to positive effects. This is the target, also for the shareholders, to achieve higher margins and to achieve more a level of profitability which is more sustainable. But the big leverages are on the cost and the efficiency side and not on the market price and yield side.

Interviewer: SWISS is operating very profitable. In the airline value chain, what do you consider as the most important aspect(s) for efficient value generation?

Michael Trestl: I think efficiency is key. You have to start with your own production where you have to see how can you really set up your operation, your production in the most efficient way. This starts with the layout of the aircraft, how many seats do we have, how many classes do we operate, and then it comes down to the operating model. So how do we plan networks and schedules to offer a good customer experience. I would really say that we for ourselves have to set a good foundation for efficient operation. And then everybody else has to feed in it. If we want to be efficient we also have to demand efficiency from our suppliers. If we want to have an efficient operation here at Zurich airport we have to define and negotiate with the different stakeholders at Zurich airport how can we achieve that efficiency. And in the end everyone needs to sit at the table and also needs to want to go towards one joint goal in terms of that efficiency. Be it the ground handler, the airport itself, Skyguide and so on. We are constantly trying to improve our efficiency in the different processes that we have.

Interviewer: In light of industry consolidation, do you think it could be beneficial for small airlines to proactively sell themselves on their own terms (from a management point of view - before getting taken over or being pushed out by competition), and if so, why? What could be possible advantages / disadvantages?

Michael Trestl: I think it very much depends on the situation because it depends on the ownership, the interst of the shareholders of that small airlines. If they want to sustain on the market, if they still want to continue to be an independent player or if you want to become part of a bigger airline. I think there's once aspect which you need to consider if you as a small airline if you don't have the interest to stay on the market as your own independent entity this proactivity which you describe could potentially give you and advantage in negotiations, because you are flexible. You don't need to sell - you can sell. But if you have to sell yourself because you are in a for example bad financial situation and you are looking for relieve of the whole situation through an acquisition by a bigger airline, the price which you might be able to achieve for your airline could be lower than if you would proactively approach airlines. In the end it comes down to the strategic intent of the ownership of the small airline. Why should you even consider offering your airline if you have a different strategic intent and if you want to stay in the market as an own entity. There is no ground to do so. So you first have to consider your strategy and where you want to go and do you see yourself as a sustainable market player or not.

Interviewer: So can you compete against the ongoing consolidation - it is more in light of that in which I am raising this question. So can I, as a small airline, continue to operate or will I be faced with that question sooner or later.

Michael Trestl: Yes exactly, do you have as I have said before a solid ground to exist in the market, do you have a market niche or market segment which you can serve and in which you can grow and which you can further exploit in the future. Can you differentiate and in this niche be successful through specialization or cost leadership or whatever strategy you pursue - these questions might be helpful to answer in a first stage. And if you come to the conclusion, and maybe you see a future of only two or three years before you come to an end of growth opportunities and an end of sustainable business making and profitability because something also might change in the market, then such a step could be a good option. But I think there is no generic answer to that question, it depends on the particular case and on the particular market, the segment and the whole constellation of the market players.

Interviewer: In your opinion, what are the major costs of mergers/acquisitions?

Michael Trestl: Usually in such M&A transactions there is a lot of particular knowledge and expertise required. I would say usually no organization is able to cope with those kind of challenges by itself. So you need to have consultants, you need to have lawyers, tax guys, financial advisors, you need to have all sorts of different advisors around the table which of course cost money and somebody has to pay for. There are all kind of different costs which are involved in the different stages of such a transaction. If you just think about the phase of due diligence - so if you would consider buying another airline, first you make up your mind and get some strategic ideas, but then if you are getting more and more concrete, there might come the stage of where you have to conduct a due diligence. And this due diligence stretches over the most relevant part, from operations to cost structures, so you really have to investigate the subject matter in all detail and from many different points of view, in order to get a really good understanding of whether this is really a company which you want to buy or not. So there are all different kinds of costs involved in that kind if activity.

Interviewer: Say, hypothetically speaking, a small airline intends to sell itself. Marks and Mirvis (2010) defined five overlapping perspectives in M&A transactions. For a successful bid/purchase and later integration, as potential ‘buyer’, what are you looking for i.e. where do you see:

1) Acquisition Trademarks (important/interesting for the buyer)
2) Key Success Factors (KSFs)
3) Stumbling blocks

<u>The five overlapping perspectives:</u>

- Strategy
- Organization
- People
- Culture
- Transition Management

Michael Trestl: I would say you have to see the different perspectives; the financial perspective, the market perspective, the operational perspective. And you have to combine all the perspectives into one holistic. If I would like to buy an airline I would need to make up my mind about what is the real asset which I am buying. Is it for example a strategic acquisition on order to get slots at a certain airport or is it also a different market perspective because I want to enhance my reach, coming back to the example of Edelweiss. SWISS wasn't in the leisure segment so with one acquisition the leisure segment was integrated. Then the financial perspective. Does the airline which I intend to buy have a favorable cost structure, and can I leverage this cost structure also for the future. So what does that mean in terms of my cost base for the operation. And especially when it comes to airlines the operational structure, the operations perspective is also very important to analyze. It's really also the asset side of the balance sheet, what is in there, how is the capital structure also of the fleet - is the fleet up do date, is it old, is it new, high or low depreciations involved, are the aircraft owned or leased and if they are leased how flexible and how favorable are those contracts. Would I like to get those contracts with the transaction or would I rather intend to cut. So I think if speaking about trademarks it's these kind of market perspectives, slots for example or get tapped into a new market segment like leisure or you could also buy a brand. Operations and financial perspectives, I think these make up the whole picture.

Interviewer: So the KSFs would be more from the point of view if you as a management want to sell your organization or in this case your airline. Considering these five overlapping perspectives where would you have to look or where would you have to direct resources to for a successful bidding process.

Michael Trestl: I think the strategic perspective which you mention here is the beginning. Because if you want this transaction to materialize and become successful I think there must be a strategic fit between the two parties. So the buyer needs to be interested in what the seller has to offer. So could it be the market, favorable cost structures, slots. I think this is a very important aspect which from my understanding also stands at the very beginning, to see if there is a market for a certain transaction. I think the remaining topics they are certainly of relevance but I would say they are secondary. But they must not be neglected, because they can also be stumbling blocks. To give you an example, one current M&A transaction we as a group are involved in a due diligence for a bankrupt airline in Italy, and if this first aspect, the strategic fit, you can tick and say ok, if I buy this airline I can significantly improve my market presence in Italy. Maybe not all of Italy is attractive but certainly the north, Milano and Rome, also to set up a certain operational structure, to expand market reach, to get slots, etc. So strategic fit: ok. But - if I have now a look in the due diligence, what is the organizational structure, what is the efficiency, what is the financial structure - I'm loosing the breath. Because even though there might be a strategic fit all of a sudden you will realize the frame conditions are not suitable. And if the frame conditions would continue like that, ultimately it would fail. So we would continue in the same bankrupt manner as now, just with a different shareholder, bearing that financial risk. And so this can be a stumbling block to say in a transaction „*you, seller, if you want to sell your airline you have make certain concessions, and you have to make compromises.*" I have a certain strategic interest, but I don't need to buy you for all price. So if you don't make concessions in regards to this and that - exactly the things you mention, the organization, the organizational structure, the cost structure, the IT systems, and all related regulations which come with it. Including labor and union regulations, and if you as a seller are not able to make substantial concessions towards a state where I as potential buyer see it feasible, you will not come into business.

Interviewer: So it could be beneficial to address these points way beforehand. For the bankrupt carrier it maybe too late, to address these issues early enough to successfully find a new owner for the entire firm.

Michael Trestl: So like I've said before, is there a generic answer to this and I would say no, because in this particular case - there always needs to be a certain pressure, a certain point of crisis until someone realizes oh, I really need to change something. In this particular case, for decades of bankruptcy always more money from the taxpayers - and this is public knowledge - was put in and so nobody cared and continued with business as usual. So it would be interesting to see if the crisis is now really so deep. So if there would be a real interest to be attractive for a potential buyer then this proactivity which you mentioned is of course helpful to trim yourself already in such a way how you would envisage the potential buyer would see you as attractive.

11.1.3 William Agius, Center for Aviation, ZHAW School of Engineering

Transcript: Interview with William Agius, Deputy Director at the Center for Aviation, ZHAW School of Engineering

Interviewer:	David Egli, Student IM
Interview partner:	William Agius Deputy Head, Center for Aviation ZHAW School of Engineering
Date:	Monday, April 23rd, 2018
Time and Location:	09:30 ZHAW School of Engineering, TV401
Language:	en

Interviewer: What do you think about small airlines in Europe? What are their advantages/opportunities and disadvantages/threats?

William Agius: Well I think the advantage in most cases is that they have much lower cost base, both in terms of salaries and in terms of the costs that are required for the production of their services. But in a way that is to a certain extent also the disadvantage. They have less costs because they are kind of not burdened down by thing as a rule - like having to operate an effective hub. They don't have to maintain any frequent flyer programs which are incredibly costly. But on the other hand it's precisely things like frequent flyer programs or operating kind of a hub / network that kind of attracts customers. And I think that's what most of the smaller airlines in Europe struggle with. That they are actually unable to attract enough passengers to have a market of their own. If you look at Helvetic Airways in Switzerland - they would definitely not have such a large fleet as they do now if it weren't for SWISS. Since most of the flights are operated sort of on a wet-lease basis most of the time. Everything that Helvetic has tried in the past has de facto failed. And if you look at Skywork which isn't aligned with anyone of the Swiss carriers, nothing they have ever tried has been a success. They even failed on the

Basel to London-City route, which they had a monopoly on. Now they are doing Basel-Vienna and inevitably the consequence was that no sooner had they announced that they would open the route, that EasyJet started operating the route, and Austrian Airlines shifted from a Dash 8 to the Embraer 190 - kind of eliminating the competition by capacity. So in a way the advantages are also their disadvantages, or their weakness. And I think all the smaller carriers in Europe don't actually have a chance of surviving unless they are aligned or sort of have an affiliation with a larger entity. But that's not always that easy to achieve, of course.

Interviewer: How about the chances of survival for small airlines in Europe/Switzerland such as Skywork and Helvetic? Are they even needed?

William Agius: I think Skywork will not survive because there is no need for them. Berne as a market is too unimportant and too small for Skywork to be relevant. Also I think the days of the small turboprops, kind of commuting between the sort of secondary airports, those days are over. EasyJet does that now and they do it very well actually. As for Helvetic Airways, I think it doesn't have a chance of survival either unless they have closer ties with SWISS. Which I think is about to happen anyway. I know this is just a minor detail but it just strikes me that the registrations of the C-Series are in the same sequence as those of Helvetic Airways. So it's JV-something. So I suspect probably what we will see happening in the near future is that SWISS' regional fleet will be transferred to Helvetic Airways and operate under their AOC. And that will be the only chance for survival of Helvetic Airways because their own operation has never made any money. Things like Bordeaux, London-Gatwick, they've always been loss making.

Interviewer: So the chances of survival are indeed small for small airlines.

William Agius: Yes, and I think Helvetic Airways will only in the long-term survive if they manage to get a larger part of the cake of SWISS' business. They probably would no longer even exist as a brand, but just as the holder of an AOC. But of course that's not going to happen from today to tomorrow because obviously that would cause a lot of upheaval within the group of pilots and flight attendants working for SWISS who may or may not want to shift to Helvetic Airways.

Interviewer: That's an interesting concept. I have never though of the SWISS fleet being operated under the AOC of Helvetic. As far as I understand the C-Series are being bought by SWISS.

William Agius: Yes - but they can always lease them out. It also looks nicer on the books. You can actually say you are generating an income on the aircraft by leasing them out to somebody else who can operate them for you at a cheaper cost base. This has always been a topic. When I worked for Swissair the topic was outsourcing the Fokker 100 fleet to Crossair, and there was a conflict because Swissair had the Fokker 100 and Crossair had the Avro RJ100. Swissair went bankrupt before that materialized and they got rid of the Fokker 100 anyway. There was a reason why SWISS created Swiss Global Air Lines and Swiss International Air Lines - it's something that I think so far SWISS has always been a bit reluctant to do because of the consequences that it would have for things like career planning. But I think the way things are going right now it will become inevitable because the costs to produce the flights are increasing, while the revenues are close to collapsing anyway.

Interviewer: In the US, the last 15 years have seen immense consolidation. How would you describe the European aviation industry trend in general?

William Agius: We are generally going in the same direction as the US, which might prove to be a niche for smaller operators. There is nothing to say that Helvetic couldn't also operate thinner routes for - I don't know - Air France? Or Alitalia? It's not likely to happen because obviously the Italians and the French could produce at an even lower cost than Helvetic, but theoretically as long as Switzerland participates in the kind of open skies that we have in Europe, theoretically there's nothing to stop them which is what happened in the states. There you have these small commuter airlines who have part of the fleet in service for United and another part of the fleet operated for Delta, for example. So that could happen in Europe, too. The difference though is that the market in Europe is actually much smaller. It's a much smaller market than the US, so I'm not really convinced that it will happen. I think probably what you are going to see in Europe is more that the small carriers will disappear and the regional carriers will disappear completely. What you will have is that the market will be divided up between the insignificant point-to-point rubbish, which the big airlines aren't interested in and which will be left to the low-cost airlines like Ryanair or Wizz Air or EasyJet or whoever - while the connecting traffic - the hubbing - will be left to the traditional network carriers. Although having said that, if you look at Lufthansa for example, originally the idea was that they would have Eurowings that would operate from all over Germany to kind of keep EasyJet, namely, out of the market, and only feeding traffic going into Frankfurt and Munich would still be Lufthansa. Now the situation has changed. Now Ryanair has based aircraft at Frankfurt, Lufthansa's hub, so I'm not really quite sure for how long Lufthansa will be able to keep that up. So theoretically we could also end up in a situation where all of Lufthansa's short-haul traffic is outsourced to Eurowings - out of necessity. And then of course the same thing would happen with SWISS, although I think then in that case it would be outsourced to Helvetic as the most likely candidate. Even though Edelweiss already operates the A320, Edelweiss' cost base is not that much better than that of SWISS. So the gain from that would be not as good as if they would outsource everything to Helvetic.

Interviewer: The positioning of Edelweiss though is also not the sort of point-to-point traffic.

William Agius: No and also the whole thing would have to be rebranded. Right now Edelweiss sees itself as kind of a boutique airline. So to reposition themselves as sort of a low-cost carrier could be done but the financial effort would just be too great. So Helvetic is the most likely candidate.

Interviewer: And now the LCCs, Ryanair for example, is also attacking this hubbing concept. They used to only station planes in the middle of nowhere, and now they are coming to the big places.

William Agius: Yes exactly. And I think one of the most recent and most interesting developments which - funnily enough the press didn't really pick up on - is if you go on the Ryanair website you see Ryanair has teamed up with Air Europa now. And on the Ryanair website you can now book a ticket from Basel to Buenos Aires. I don't know how it works ticketing wise, if it's two separate tickets so that no airline is responsible in case of a missed connection - I have now idea. But the fact that you can do it, that they're teaming up, already says a lot. EasyJet and Emirates already do the same in Milano.

EasyJet has quite an operation in Milano Malpensa, and they are actually officially cooperating with the Emirates flight. Emirates has one flight that goes from Dubai via Milano to JFK. And EasyJet does as far as possible feed in that flight. And that's actually quite interesting because it's a very new development, very unique. So it will be interesting to see how it works. If we compare again the situation with the states, in the US we've reached a stage where even the Legacy carriers, the service they provide on board is on a par with that of a low-cost carrier in Europe. And as the revenues continue to decay in Europe I think it'll be inevitable that we will have the same standard in Europe. So you might as well outsource the whole thing to a low-cost carrier anyway. Unless you're kind of willing to dilute your brand to that extent that you say, yeah we are the great Lufthansa but still on short-haul you don't anything for your money.

Interviewer: Swiss didn't sound like they want to give it up. Other than in Geneva anyway, where they are under a lot of pressure, so they need to adapt.

William Agius: Yes and I think in Geneva they are going to introduce it and not before long they will be doing the same from Zurich, they can't afford to do anything else.

Interviewer: Considering Porter's five forces – Industry Competitiveness, Threat of New Entrants, Power of Buyers, Power of Suppliers, Threat of Substitutes – how do you perceive these forces at work in Europe?

William Agius: They are very much at work I think in the European aviation sector, and they are kind of working against the industry. Again an example from Lufthansa, which I think is interesting. Lufthansa has decided that to kind of save money, so to increase it's industry competitiveness basically, they are going to standardize the cabins. So that all of them, from the inside, will look the same. They'll all have the same seats, the same seating configuration - whether you are on Lufthansa, Eurowings, Swiss, Austrian Airlines, or SN Brussels Airlines. On paper the whole thing makes sense but the truth of the matter is that Lufthansa is not willing to kind of design a European economy class seat, specifically for it's purposes. So they basically use the same seat that Iberia has installed, BA has installed, and EasyJet has installed. So in a way the need to become more competitive by driving the costs down has led to a situation where the product is being increasingly diluted to the extent that there is nothing to distinguish one product from the other. If you add to that the fact that BA has introduced buy-on-board and SWISS is introducing buy-on-board in Geneva and probably very soon from Zurich, if you think about it, what means do you have to distinguish yourself from the competition. If the cabin, so the look of the aircraft is no longer a criteria because once you're in the plane you don't know if it's an Iberia, a Vueling, or a Lufthansa anyway because they just look the same - gray in gray. The only other possibility you have is the interaction you have with your crew. But if service is buy-on-board only then that means that the opportunities for any interaction between the cabin crew and the passenger are only limited to those cases where the passenger is willing to fork out a fairly high amount of money to make an on board purchase. If you are not willing to do that - and I have noticed that myself - if you stick your ear plugs in you can go a whole flight and have zero interaction with the crew. I am not blaming them, it's in the nature of the beast. The result of that is that the products are being increasingly diluted to the extent that you can no longer distinguish one from the other. So coming to the power of suppliers, the thing is that the airlines have no other solution, there's no way out of the situation they find themselves in. That is not exactly helping their case. So mainly the competitiveness and the need to be more competitive is having a paradoxical effect in that it is making them less competitive because it's all becoming the same. Interestingly enough one of the airlines that is kind of different in that respect is KLM. KLM has realized that the possibilities to distinguish themselves on board or with their aircraft are fairly limited. What KLM for example does really well is customer service - in case of an irregularity they will proactively deal with passengers, rebook them etc. - that is something for example Lufthansa and SWISS are absolutely atrocious at. There is zero customer service at SWISS. If there is an irregularity it's essentially your problem.

Interviewer: So you would define competitiveness as…

William Agius: I would say nowadays it is the service level an airline is able to provide it's passengers. But the interesting thing is that even though it's an airline and airplanes are their business, the service delivery happens exclusively outside the aircraft. Completely outside the aircraft. And that is the only means of being competitive that the airlines have nowadays. The financial pressure is on for all of them, that does not distinguish them but rather is what unites them in fact.

Interviewer: We also see Ryanair, all of a sudden conducting customer care.

William Agius: Yes exactly, that's precisely it. In the beginning, Michael O'Leary prided himself in being a complete asshole. There was something very arrogant and sort of this German attitude of „*Geiz ist Geil*". That was maybe sexy in the beginning when the low-cost carriers emerged on the market but what we've actually seen is that the distinction between the low-cost and full-frills airlines can no longer be made. I wonder if actually it ever could be made. The thing is nowadays no one actually cares if you say „*We are Ryanair, we're a low cost carrier*". So what? I can get the same product for pretty much a similar price if I book with SWISS. So that's not an excuse anymore. And it has put on the pressure on the low cost carriers too. It has made flying a lot more attractive for the general public, which is part of the problem. It has become too attractive because now people who never otherwise would have stepped a foot on a plane are now flying, leaving to all sorts of other problems.

Interviewer: How would you rate the Threat of New Entrants into the industry?

William Agius: There is always the threat of new entrants, and the thing is we haven't reached the end. This is not the final state of the intra-European aviation industry. I think there is a risk but it's hard to say what that risk is or in what way it will sort of manifest itself. It's like looking into a crystal ball right now. The threat exists, but in a way I think again in Europe we are not quite that far yet. The pressure is not on enough - new entrants emerge out of necessity to meet a market demand. And I think right now the market is in a state where it's actually slowly stabilizing after a lot of upheaval. But I think the elapse time before the next upheaval is going to be much shorter than it's been so far. The big ones in Europe - be it IAG, Air France-KLM, or Lufthansa Group - have had to do a lot of changes in very short time. But the changes they have implemented will be of fairly limited duration before the next big thing comes. But what that will be is difficult to say.

Interviewer: Do regulators in Europe differ from other markets (US, Asia) and if so, how?

William Agius: Well if you look at Nikki, that really blew up in Lufthansa's face. If you look at Zurich, the upshot of Lufthansa even trying to manipulate the regulator is that this summer there will be two 737s of Ryanair parked in Zurich, operating out of Zurich. That's what they got from trying to manipulate the market. It really has backfired on them, this is not what they had in mind or what they had anticipated. But this is the consequence because the Austrian regulator eventually said enough is enough. The one laughing all the way to the bank is yet again Nikki Lauda. But the result is that there are now Ryanair aircraft in every one of the Star Alliance hubs, in every of Lufthansa's hubs. This is not how this was supposed to work out. The thing is that in the US there is one regulator only whereas in Europe there is a regulator in every country. If you're lucky it's an EU country but there are also a few non-EU countries. And those regulators are still very much concerned in making sure that they can protect their markets. Because they already know that they're at a disadvantage by not being a member of the EU. The same thing also goes for Asia. There are markets which are opening up, for example Japan. Japan is definitely not quite as closed and regulated as it used to be, but the Japanese market is still very much a closed up market. I think in Europe what we see right now is that the regulators are fighting the airlines to ensure competitiveness because that is on the agenda of the European Union. Whereas previously it is safe to say that the regulators were the servants of airlines and they did as the airlines dictated, to protect national interest. But they are no longer able to do that so the role of the regulators has changed quite a lot in Europe I think. Within a European context there isn't really that much the European Union countries can do anymore. A very good example of that was Brexit. No sooner was Brexit announced had EasyJet transferred its AOC to Austria and now every aircraft is registered in Austria, to ensure that they still have access to the EU market because they couldn't have that from the UK, or they don't know if they could have it from the UK. The only thing that is left for the regulators is to protect the long-haul traffic. As you could see with Emirates. Emirates wanted to fly from Dubai via Zurich to Mexico City. That was really a case where the Swiss regulator said „*Do whatever you like with Basel and Geneva, but you are not touching Zurich*". Even though I very much doubt that any other airline will be flying from Zurich to Mexico City anytime soon, but still just to protect the market the automatic reaction is always no.

Interviewer: Is flying a commodity nowadays, and are Legacy carriers becoming LCCs?

William Agius: Yes it is. It's hard to say which way the trend of Legacy and LCC carriers is going, I think they are aligning to sort of meet somewhere in the middle. Maybe what we'll see is not necessarily a new entrant but maybe we'll see the rules of the game changing. The airports in Europe have too much traffic. The only airport that doesn't is Madrid Barajas, but all the other ones are really at full or overcapacity. If you take an airport like Heathrow - I was talking to a guy from Eurocontrol - in actual fact, in Heathrow the arrival sequence is determined before the aircraft even enter British airspace. By the time they enter British airspace it's too late for sequencing. All the airports are like that, Charles de Gaulle is reaching that point, Amsterdam is already there, Frankfurt exactly the same thing. So one possible future development might be that there might be a move within the European Union to put a limit on what is permissible in terms of flights duration or flight length. So that for example flights of less than - I'm just inventing something - 500 km will no longer be allowed within Europe. There is a likelihood of something like that happening. Which the airlines would actually be quite happy with. The traditional legacy carriers would be happy because it would eliminate part of the competition, because a lot of the routes the low-cost carriers operate are very often 500 km or a bit less, so they wouldn't mind. Secondly it would free up slots at the hubs for possibly more lucrative destinations. And that is something that also needs to be factored in, the alternative then is taking a train. The trains are trying to catch up too now. An excellent example of that is Basel. A very long time ago there was Air Inter, and they actually had wide-body services between Basel and Paris, more than one a day in an A300. Now we've reached a stage where Paris Charles de Gaulle is usually served with an EMB170 four times a day, and Orly with an ATR 472. That's it. Eight flights a day to Paris is still a lot but it's a lot less than what they used to have because the TGV has taken over a lot of that traffic. So that might be a development in the future, that the railways will start competing the airlines in the European market. And that then is the benefit of the European market that compared to the US Europe is a much much smaller geographical sort of entity.

Interviewer: What do you think about the impact of consolidation on:

- Efficiency in terms of margins
- Prices
- Diversity of choice

William Agius: I think if you look on a large scale - lets say the 1990s until today, a span of nearly 30 years - I think you can say that prices have gone down considerably. Not just the prices but also the fare rules that are attached to the prices. Before the low-cost carriers came into being, there were all these rules where a one-way ticket within Europe cost a really scandalous amount of money. There was a chance that for a one-way ticket from Zurich to London you could pay something like 2,000 - 2,500 Francs, and that was in economy class. That is something that the low-cost carriers have stopped. Today most legacy carriers don't have one-way pricing anymore, or they do but one-way pricing has become equivalent to what used to be the half return. So they have actually brought down the prices. The question is what will happen as consolidation continues. If we end up with just a few players in the market, then inevitably this would mean that the prices would go up which is obviously what the airlines are trying to do. The example we had before of Basel-Vienna: Austrian Airlines and EasyJet are only trying to kill Skywork, and once they have achieved that we can assume that Austrian will return to using the Dash 8 and the prices will go up again. They will have the business traffic and EasyJet will have everybody else. But until then you can definitely say that the prices generally have gone down. **Diversity of choice:** I think what has changed is because of the low cost carriers, the customer has a much lower expectation. So previously if you wanted to fly from somewhere in Scandinavia to Spain for a bit a sum, there was a bit this expectation of *it had to be a non-stop flight if you don't mind*, and I think now with the low cost carriers what we have seen is more and more self-hubbing. So you don't buy a ticket with SWISS from Copenhagen via Zurich to Malaga, but that you figure „*Ok, I can take a low-cost carrier from Copenhagen to Paris and I know that Transavia has a flight from Orly to Malaga. So theoretically I could fly to Paris, maybe spend a day or two there and then continue*." So you no longer rely on one airline to provide the whole service from A via B to C. So there is more diversity, I think the market has adapted and learned that you don't need to rely on a non-stop service and you don't need to rely on one airline to produce the service you need. You can piece it together the way you like. Having learnt their lesson, if something goes wrong, even the legacy carriers are not necessarily willing to help you, because they have lowered their standards to those of the low cost carriers. **Efficiency**: That's really a difficult one to say. If you look at SWISS they have decided that the Geneva operation has to become profitable. And to that end they are replacing all the airbuses there with the C-Series. SWISS' management has already said that they are not going to consider the connecting long-haul traffic - so the flights to New York, the United service from Washington, and the Air Canada flight from Montreal are not part of the equation. So they really want to see that the point-to-point traffic from Geneva is actually running at a profit. Good luck with that. I am not quite sure how on earth they actually expect to be able to take that apart. What the legacy carriers have that the low-cost carriers don't have is that they can chose if they want more or less connecting traffic. So theoretically SWISS can say "*ok the flight from Madrid to Zurich we'll open it up for connecting flights"*, or not. That's something they can easily steer. Having said that though, now that they have the triple seven, the truth of the matter is SWISS has produced significant overcapacity in its own market. The triple seven cannot be filled from Zurich alone, on no route. Whether it's Hong Kong, Singapore, it doesn't matter. You cannot fill a triple seven from Zurich. So in a way no matter how cost effective they want their short haul operation to be, because of certain changes that have been implemented on their mid- and long-haul fleet, they now have to rely on filling their aircraft with connecting passengers. So that again the efficiency of the short-haul product becomes quite diminished. For SWISS, the cost synergies from the group are not as significant as one might think. Just because Lufthansa has A320s and SWISS, and Austrian, and SN Brussels does not necessarily mean they're going to close down every flight training organization and only do their training for the whole Lufthansa group in one place, which would be the most effective thing to do. There, politics come into it. It would be the most effective thing probably to move everything to Austria and Belgium, they have the lowest salary base. But that hasn't happened. We still have flight training organizations in all these countries that cater to the needs of Austrian, of SWISS, or whoever. That won't change. So they're cost effective where they can be, and where politics don't get in the way. Lufthansa still has a pending order for the A350 - they've launched a competition amongst the Lufthansa group, basically Brussels, Vienna, or Zurich will get the 350s depending on who ends up being more profitable. And that's just about who has the most sales and best revenue management, that's about it. It's not like they're fully taking advantage of any synergies. Except when they make a bulk order for seats that they can install in all their aircraft. They could do much better, but they can't go down that road yet. They will have to decide at some point if they really want to make the effort to paint a few airplanes in red and white and operate them out of Zurich, or if everything will just be identical and there will be a Lufthansa group livery for example. With a Lufthansa group uniform, Lufthansa group service, etc. Because with what they have right now there is no reason why SWISS's triple seven should have a different business class than Austrian Airline's triple seven. There really is no point. But of course one has to accept that that will dilute the product significantly. The question is if they're willing to go down that road and I think they will eventually, but as I mentioned before, the pressure isn't on enough yet. It hasn't become that bad yet, but it will.

Interviewer: In the airline value chain, what do you consider as the most important aspect(s) for efficient value generation?

William Agius: I would say the Human Resources. That is one of the biggest problems. The airline industry is very labor intensive. If you take an airline like Emirates or any airline that operates the A380, your crew alone to operate a flight from Zurich to Dubai - which is really short actually, just 6 hours - you need 56 crew. Just crew! That's before everything on the ground, that's before doing any form of maintenance on the aircraft, that's before having sold a single ticket. That costs a lot of money. That really costs a painful amount of money. And that is obviously something that Lufthansa has identified and Air France, I think, and that they're trying to tackle. The only problem is though that they're really moving on very dangerous ground right now, especially Lufthansa. The people that work for Eurowings, and I think this will inevitably also come for Lufthansa, don't work for Eurowings. The people who work for Eurowings have a contract with a contractor who offers them a contract that's limited for 3 years, without the possibility of extending it and without the right to participate in a union. Quite simply, the people who work for Eurowings couldn't give a shit. It's whether they're working for Eurowings or they're working for Lufthansa, or they're working for Air Portugal is totally insignificant. It's not important. There is zero identification, which again starts the spiral going of yes, basically the products of the European airlines becoming so interchangeable that you cannot distinguish one from the other. So you can try to bring down the cost by outsourcing your human resource, but I think that may end up blowing up in their faces. Because there is zero identification. And the airline industry seems to be an industry where a lot relies on brand recognition and brand identification. And as that becomes more and more diluted, the pressure increases to be able to do something to attract more customers. There's no loyalty from your customer base anymore.

Interviewer: In light of industry consolidation, do you think it could be beneficial for small airlines to proactively sell themselves on their own terms (from a management point of view - before getting taken over or being pushed out by competition)? What could be possible advantages / disadvantages?

William Agius: I don't think that would work. Because basically what you are saying is that we're becoming increasingly desperate. And once it becomes apparent to your opponent that you are desperate, they dictate the price.

Interviewer: If you are desperate. SWISS for example was desperate, losing tons of cash etc. But if I have a product like Helvetic for example - they're not desperate I would say. They're just relying on the contracts they have with SWISS. But if they would say „*Ok if these contracts are terminated, we're gone, so it could be better for us to be bought by SWISS.*"

William Agius: But what would be the benefit of SWISS taking over Helvetic? If they take over Helvetic, the very first thing that will happen - because I witnessed that when I still worked for SWISS – is this: When Lufthansa took over SWISS, within literally two hours of Lufthansa announcing that they were taking over SWISS, the union of the Swiss pilots Aeropers had already had the first meeting with Lufthansa's pilots union. The pilot unions were incredibly well organized. Much better than the rest of the airline. And exactly the same thing would happen. The pilots would immediately meet, because that's what they did with Lufthansa and Swiss. And they signed a (pact). They would not work against each other. Lufthansa pilots promised, and the Swiss pilots did the same, that they would not do anything that could jeopardize the other people's salaries. They would not create a situation where they would be in competition, to protect they're old, what they consider 'god given rights' as pilots. That hasn't changed. The first thing that would happen if SWISS announces we're taking over Helvetic, you can assume it will take less than two hours because they're in the same country. The Helvetic's pilots union would definitely get in touch with the Swiss pilot's union. And with that, the advantage of operating as Helvetic goes to shit. Because Helvetic's big advantage is that their salaries are much cheaper. But you ruin that by taking them over. For SWISS, Helvetic as a wet-leaser is far more attractive than full out ownership. Why on earth should they want to take over Helvetic.

Interviewer: Well SWISS said this question arises periodically, so evidently there are some reasons in favor of a future takeover, no?

William Agius: I mean it can be, but only in very exceptional cases. Just as an example, many moons ago Air France took over Sabena, and because they really are such a bad airline, Sabena did actually bankrupt Air France, did you know about that? Air France officially went bankrupt. You are probably too young to remember but there used to be a company which was called UTA - Union de Transports Aériens - so what happened was the French government sold all of Air France to UTA for 1 Franc. But they decided that Air France had better brand recognition so the name UTA was eliminated and the new entity continued to operate as Air France. But the Air France we have today is actually a bankrupted company that was bought by a private company. Does that ring a bell? 2002, Crossair buys Swissair. There obviously they couldn't be quite so outrageous about it as the French were, so they couldn't keep the name Swissair, they couldn't even keep SR code. So the whole thing turned into Swiss International Air Lines. This happens over and over again, it's the same thing that happened in Austria when suddenly Lauda Air bought Austrian Airlines but miraculously, surprisingly, the brand Austrian Airlines was maintained and not Lauda Air. In such a situation yes, we might reach a point one day where Helvetic may have to purchase SWISS, because SWISS has become too expensive, that may happen. But in case that ever happens, strategically it's far more convenient to not own these carriers. But to have a very strong dependence, which is what we have right now. Without SWISS's sales platform an Edelweiss would be nowhere, and without all the wet-leasing they do for SWISS, Helvetic would be bankrupt.

Interviewer: The interesting fact remains though that Edelweiss is still Edelweiss, it's operating under its own name, it has lots of freedoms, and a very strong brand.

William Agius: Now they have what, 4 wide-bodies? The sad rejects that SWISS doesn't want any more, two A340s and two A330s. Let's face it, the 340s are being operated on behalf of SWISS, that's a fact. For an airline like Edelweiss it makes really absolutely no sense to operate to Buenos Aires or to Rio. They're not such sexy holiday destinations to warrant a holiday airline flight to those destinations. But they are very attractive to SWISS to do a bit of experimentation. See how the market will react. I don't think the market will react very well because they have such few flights, I mean it's something like three times a week which is ridiculous. It's really useless. If you can fly daily with Iberia via Madrid and daily with Air France or Lufthansa via Paris or Frankfurt, I really don't think the market will be too impressed by three direct flights by Edelweiss. Especially given that the market between Switzerland and Argentina simply isn't big enough.

Interviewer: Still they're making money, no?

William Agius: But again there's a question of transparency. To what extent you can clearly absolutely say that Edelweiss is making money is I think questionable. Of course they are making money if SWISS is footing the bill every time they operate a service on their behalf. Every time SWISS sends an Edelweiss A320 to Amsterdam, and they do that quite often, SWISS foots the whole bill. It's not like Edelweiss has to pay for any of that, they get paid to do it. So no wonder they're making money. But as a whole - I wouldn't be quite so sure. It's not quite as rosy as they make it out to be, let's put it that way.

Interviewer: Say, a small airline intends to sell itself. Marks and Mirvis (2010) defined five overlapping perspectives in M&A transactions (see next page). For a successful bid/purchase and later integration where do you see:

1) Acquisition Trademarks (important/interesting for the buyer)
2) Key Success Factors (KSFs)
3) Stumbling blocks

William Agius: What would make anybody take over an airline is the access to the market the takeover would give them. That's it. Which is probably why for example Virgin America was so attractive because Alaska still operates out of a niche, stuck up in the sort of north-western corner of the US. They have an extensive network; I'm not saying they don't but by merging with Virgin America they have significantly increased their network. Without the burden of having to buy additional aircraft, and all of that. They taking it over and it's already sort of 'ready made'. That again is kind of the American context, but I think in Europe - I mean I know for sure that's what it was for Lufthansa or for BA when they bought SWISS - the only thing Lufthansa was interested in when they took over SWISS was not the fleet, it was not their staff, it was not the slots, it was only the frequent flyer data. That was Swissair's biggest asset. Because Switzerland is such an affluent market. The CEO of BA, Willy Walsh, he actually said once - it was quite funny, I met him in Zurich – "*The Swiss market is really wonderful, it's just a shame* *it's so small.*" Because it's true, the buying power in Switzerland is really still very high. It's a very attractive market. But that also means you have to make sure you get the biggest chunk of that market because it's so limited. So with Lufthansa it was just the frequent flyers, that's what they paid for. Everything else what kind of nice to have but not really that important. It really is the market access and how easy the M&A will allow you to expand your market.

Interviewer: So the KSFs and the stumbling blocks are more to be seen from the point of view of the management of the seller. So Virgin America for example, they knew Alaska wanted access to the west coast, and they could offer it. They leveraged this to drive up the price, and I mean they got a really good price. So that was beneficial for the Virgin management and shareholders.

William Agius: They got an excellent price, absolutely. But if you look at SWISS for example, they got a really bad deal both with Lufthansa and with BA. Because they were really desperate and everybody knew it. I remember when BA took over SWISS one of the first things that happened was they handed over something like 8 slot pairs to BA. But the purchase price that BA paid for SWISS was how much? Not very much. But those 8 slot pairs in Heathrow would have cost a lot more than what BA was going to pay for Swiss. But they were so desperate they didn't have a choice. And BA said „*thank you very much we'll take those slots and run with them*", they never gave them back, coincidentally.

Interviewer: So the KSFs or the stumbling blocks, where would you see them in the five perspectives of Marks and Mirvis?

William Agius: The stumbling bocks for the entity that would buy?

Interviewer: For the entity that would sell.

William Agius: Again I think the staff. They would be the stumbling block. You would be up against a lot of opposition. Some of it purely emotional. That you know, people identify with their company. It was the same thing with SWISS. When I left SWISS we were still very much 'are you a Swissair or a Crossair guy', there was a lot of animosity within the company. And the best thing that could have happened to SWISS was that they were taken over by Lufthansa because then everybody was united in hating Lufthansa. So that kind of helped. But there is also the thing with the pilots. Not so much for the seller, but that I think is something they would have to contend with. Because of course on paper it looks very sexy if you can say we only pay this and this much in terms of salary, but it’s unlikely they’d be able to uphold that in case of a take over.

Interviewer: It would be interesting to know what happened in the Virgin America case, if the pilots met.

William Agius: In that respect the states are very different to Europe because in the states you don’t have things like unions.

Interviewer: You have a pilots union though.

William Agius: You do but they are not so strong. They are definitely not as strong as they are in Europe. What you have in the states usually is that during the kind of affluent years when it really was a pilots market and all the airlines were expanding and really desperate to get their hands on pilots, what happened is that many airlines introduced these ridiculous scope clauses. They said that if the airline starts expanding they can use a regional airline or regional aircraft but only up to a capacity of 100 seats. Everything that’s more than a 100 seats would have to be operated by the main line fleet, to protect the pilots. These are things some of the American carriers still struggle with today. That you don’t have to that extent in Europe yet. So in that respect they are different. The power of the pilots unions is not as big as it is still in Europe. Realistically speaking we can expect Lufthansa to head in the direction of more strikes in the future.

Interviewer: So say you can align your staff, or especially the pilots, with your intention to sell, then you can turn a stumbling block into a KSF.

William Agius: Yes, then you have a chance. But it really is a big stumbling stumbling block. It’s kind of the elephant in the room.

Interviewer: The question is also whether at some point someone might come to the conclusion that proactively selling is a good option, before going bankrupt or facing a hostile takeover.

William Agius: I think it's becoming increasingly difficult for niche players to find valuable arguments that would make them attractive for a big player to take them over. I don't think there have been any, have there? I mean there was Air One and Alitalia but again that was the Italian government cooking the books because Alitalia went bankrupt for like the 40th time in as many years. Olympic and Aegean, where Olympic kind of was merged partially into Aegean. But again there were all fairly crass examples that occurred in a situation where really the national investment was at stake. The investment of the Greek or Italian government was in jeopardy and so out of necessity the airlines were given the task of taking over parts of these airlines that should actually have gone bankrupt decades ago. So that was a different situation.

11.1.4 Dr. Andreas Wittmer, CFAC, University of St. Gallen

Transcript: Interview with Dr. Andreas Wittmer, CEMS Academic Director & Head of International Networks, University of St. Gallen

Interviewer:	David Egli, Student IM
Interview partner:	Dr. Andreas Wittmer CEMS Academic Director & Head of International Networks University of St. Gallen
Date:	Wednesday, April 25, 2018
Time and Location:	10:30 University of St. Gallen
Language:	en

Interviewer: What do you think about small airlines in Europe? What are their advantages/opportunities and disadvantages/threats?

Andreas Wittmer: Advantages are maybe that they are more flexible. Smaller companies, more flexible and more dynamic, can react better on markets but the negative effect of that is that they are dependent on the market, dependent on big ones. Helvetic for example is, with the wet-lease agreements, completely dependent on SWISS, otherwise it's difficult. So small airlines do not realize and do not get the scale and scope economies you actually need to survive. Second of all often these smaller airlines operate rather small planes and are in niche markets, so in smaller markets. If you have a real niche that can work, if you don't have a niche and are just a small airline without a specific niche, then it's really difficult. So for a small airline with small planes is difficult - small planes for me are all the planes that have less than 100 seats. A general statement could be „*Any plane that has less than 100 seats is not really getting you into profits.*" So if you have to fly with planes smaller than 100 seats you are most likely not getting into profits anyway, so you should not do it. Except in a certain niche. For example, People's Airline here (in Altenrhein, A/N), flying to Vienna four times a day, having the people from Voralberg who need to go to the Headquarters in Vienna, is filled every day. At least in the morning and the evening and then they fly a couple times during the day where it's maybe not as filled, but overall good because they have the specific niche. They can charge 300-400 Euros for a return flight because they are in that niche and have no competition, basically have a monopoly on that route. Because they are owned by the airport they have synergies in the whole management and support processes, so by this it works. These are 70 seat something planes, so that works fine here. But otherwise; other example Skywork - no specific niche, small home market, small planes - every couple years you have a new investor that pumps money in it and then loses it. And that's clear, it's probably not going to work. So small airlines need niches otherwise it doesn't work and minimum size of planes are 100 seats, that's when you are able to generate some value. Although even then it is difficult, because you need about 100 seats just to cover the costs of operations.

Interviewer: How about the chances of survival for small airlines in Europe/Switzerland such as Skywork and Helvetic? Are they even needed?

Andreas Wittmer: They depend on investors that are willing and emotional to just spend money on them, if you look at really small ones like Skywork. Or Helvetic, they just depend the big brother or let's say the big SWISS that gives them the wet-lease contracts - Helvetic without those contracts would not have the same amount and definitely not the same size of planes. So in my opinion, Helvetic and Skywork are both negligible, these airlines are not really needed for the market, they are not really relevant for the market, they're not really relevant for the connectivity of Switzerland, not for Europe or anything else. They are just there because one is sponsored by someone who loses money and the other one is just sponsored by SWISS and gets some work to do for them.

Interviewer: In the US, the last 15 years have seen immense consolidation. How would you describe the European aviation industry trend in general?

Andreas Wittmer: Well we have the consolidation as well, be aware that we have three big airlines in Europe - we have IAG with BA and Iberia, Lufthansa with all the subsidies, and Air France-KLM. We have the same integrations but have kept the brands. Then we have the low-cost carriers that are separate and we have certain regional carriers still on the market. I think for big airlines these small airlines are not so relevant, it's more about the assets. So if you own planes, and if an airline wants to grow and needs planes, and Airbus has a waiting list of eight years to get a new Airbus A320, what do you do? Lets assume Helvetic would have A320s and SWISS needs a couple A320s but would have to wait eight years to get them. You better just buy Helvetic. And then you have those planes, paint SWISS on them, and start operating. It's a way of buying planes - you can buy airlines, but you are basically buying planes. And the second thing you buy is slots. Slots at airports are scarce resources. If you don't have slots, and airports are full, then if an airline has certain slots you are interested in and if it has certain planes you're interested in, you buy planes and slots. And then you just look how much the value is. Actually, an airline could have a rather low market value, especially regional carriers. Maybe the market value of airlines is sometimes lower than the actual value of their planes would be if they just sold the aircraft. So actually it could be a good deal to buy an airline instead of new equipment. And I can even get the slots for it on top. It's different if you have an airline that leases all the planes. So if you have leasing contracts, the question then is if you want to take over those contracts. Still it's interesting because the aircraft are there and ready to be operated, and so are the people that operate them. You don't have to employ new staff, you can just take them over. And you don't have to order a new plane and wait eight years. You can get it right now, and that's valuable. In the life cycle of the industry, when you have growth that really goes fast, you need it now - in five years from now we might be in a downturn and you won't need it. But now you do, so you can go into a wet-lease contract, just lease another airline to operate for you or you can just buy one. So the buy thing would be interesting.

Interviewer: So you would say we are going to end up with a lot fewer airlines in the future?

Andreas Wittmer: Yes, I hope so for the industry. I would assume that we are going to end up with the big three, as in the US. And within that we will probably have the other ones all linked to those.

Interviewer: In the airline value chain (below: Porter's Value Chain), what do you consider as the most important aspect(s) for efficient value generation?

Andreas Wittmer: You can always integrate support processes. Although because you are geographically different, with different locations - if you take Iberia and BA, with locations in Spain and England - you need the support processes and firm infrastructures at both sides. There it's questionable how much integration you can generate. But you have synergies in procurement, in technology development, and in operations. You can actually integrate and harmonize your networks. So maybe you look at what slots you have at which airports, and then you maybe have complementary slots which work quite well together in the network. But for me very relevant is also culture, structure, and strategy. How can you align the strategy, how can you implement the structure over the companies, and how can you align the culture. And that is usually the big challenge in these companies. Airline companies are really emotional. Look at SWISS, it took them more than 10 years to fully integrate the former Crossair pilots and the former Swissair pilots into one pilots union. They had two unions and two fleets, with Swiss International Air Lines and Swiss Global Airlines. Swiss Global Air Lines operates in Europe - former Crossair - and Swiss International is former Swissair operating intercontinentally; and it took them more than ten years to integrate those two. And it only happened when the former CEO of SWISS said: „*Well, the new triple sevens are going to Swiss Global Air Lines.*“ So the former Crossair pilots that operate European flights are getting the new flagship. Only then, former Swissair people in their union said: „*Hey stop, that can't work!*“, and started to negotiate. So you see, sometimes it's a costly challenge afterwards, to really integrate. I think in the airline industry, integration is supported by airlines that go into alliances. If you are in an alliance, lets say you are working together at Star Alliance for ten years, collaborate and harmonize your network, sell together and realize some synergies in the alliance and then integrate fully by merging - it's just the last step of a long process which you have conducted in the network and by going through different levels in the alliance. And that is more success oriented. If you look at BA and Iberia, they were in the same alliance (one World, A/N) and moved closer and closer up to the point where they integrated fully. If you look at KLM and Air France, they collaborated in the Sky Team alliance and moved closer together. If you look at Lufthansa, it's Star Alliance - so is SWISS, Austrian, SN Brussels. LOT for example, the Polish airline, is also Star Alliance. So I wonder how long it will take until LOT is bought by Lufthansa - probably not too far away. Scandinavian Airlines is also Star Alliance so the question there is the same. This is the obvious way, you integrate within your network and over time integrate more and more revenue and cost synergies. Interesting is that in the Alliance you have a great number of revenue synergies, whereas in the full integration you more focus on cost synergies. In an alliance you do not have a lot of cost synergies. It's probably 90/10, 90% of the synergies you can generate are rather on the revenue side and maybe only 10% on the cost side. So mergers make complete sense, if you want to reduce costs then you need to merge. If you want to increase revenues you can go into an alliance.

Interviewer: In light of industry consolidation, do you think it could be beneficial for small airlines to proactively sell themselves on their own terms (e.g. like Virgin America - from a management point of view, before getting taken over or being pushed out by competition)? What could be possible advantages / disadvantages?

Andreas Wittmer: Well I find this a very interesting aspect and a very interesting idea. If you look at the industry and see consolidation, and you're one of the small ones and you know that you are probably not going to survive anyway, why not proactively making sure you get most out of that situation by actually searching and looking for integration on your side. I think it's a smart way of thinking about it. Otherwise you are taken over. And if you are taken over, you are taken over at the rules of the other party, and you don't have much to say. This way you could rather find a partner and say lets integrate in five years from now, and in those five years we work towards it in close collaboration. And again you increase the success rate in a kind of slow motion, and start to realize synergies in certain terms. If we look at Helvetic and SWISS, it would be easy to just take over Helvetic. These planes fly already for SWISS and it would be rather easy. What's the reason SWISS is not doing this? It's very simple: Helvetic pays lower salaries than SWISS does. SWISS unions demand higher salaries, pilots earn more, so for them it's a good deal to keep them in a separate company. The pilot salaries at Helvetic are much lower, a pilot earns maybe CHF 4,000 or 5,000 a month and with SWISS they earn CHF 8,000 -12,000 a month or so.

Interviewer: And the lower cost base is a major advantage that disappears if the staff demands equal pay.

Andreas Wittmer: Yes. But lets assume Helvetic is a stock rated company. And SWISS buys 51%. Or 100%. But keeps it a separate company - like Lufthansa bought 100% of SWISS but left it a separate company, they have different salary structures at Lufthansa.

Interviewer: That could be more beneficial for Helvetic then, concerning their long-term survival. Belonging to SWISS rather than relying on the contracts that could be terminated at some point.

Andreas Wittmer: Exactly. I mean Edelweiss is one of those. SWISS or basically Lufthansa fully took over Edelweiss. But by looking at the incomes of Edelweiss captains you see that they are maybe making between CHF 120k and 150k a year, whereas SWISS captains maybe earn CHF 180k to 230k or something. So an A340 pilot of Edelweiss earns significantly less than an A340 pilot of SWISS – CHF 50k or 60k less, so that's a good deal.

Interviewer: Say a small airline intends to sell itself. Marks and Mirvis (2010) defined five overlapping perspectives in M&A transactions (see below). For a successful auction/purchase and later integration where do you see:

Andreas Wittmer: Cost Structure and availability of planes. I mean strategic fit for me is the question 'are you a low-cost carrier or a network carrier'. If it's a low-cost you are not going for it, because of the completely different mind set of people you cannot use the employees, and the completely different setup that is hard to change, so you would need to keep it as a low-cost carrier. Or you could argue we want to become more cost efficient and want to have some people that come from the low-cost business to change our culture and our way of thinking. But that would be more difficult. Usually strategic fit is more the business model fit, so for me the organizational part seems to be more important. People is a big challenge, but I don't see the issue - so if you have a choice of going to a bigger and better airline, while being in one that you know is maybe not going to survive without a bigger partner, I think most people see that as an opportunity. I think the value of tiers is small because I think in a case of a regional airline everyone is always aware that they might lose their job. I guess everyone is rather seeing the benefits of an acquisition or of an integration rather than the opposite. Culture is always a challenge. But they have the similar industry. I usually look at national cultures, industry cultures, and organizational cultures. So national culture, the background of the employees, obviously depends but may not be the major issue in such a case. But the industry culture is the same, you have the aviation culture; they have the aviation DNA in their blood, they are aviators and all love planes and love to fly and all have this kind of heart for it. And they cannot get rid of it. Just yesterday I met a person who said „*I've considered to leave the aviation business but I just couldn't, because it's so interesting, I cannot get out of this industry.*" So you have this DNA of aviation, independent of what airline you have worked for. And that helps because you have a common denominator. So from a culture perspective you can say similar industry culture but of course the organizational culture might be very different. That's why I say if you have a low-cost carrier culture, so like Ryanair, and a SWISS culture, it might be quite different. That might be a big challenge. But that's probably why Ryanair would not be the target SWISS would look at. But a Helvetic, which is a regional airline with a lot of Swiss and German people working there that are similarly minded then within the aviation culture this is probably an easy take.

Interviewer: And from the seller's perspective?

Andreas Wittmer: I think from the seller's perspective it's just about ensuring sustainable existence on the market somehow and getting the most out of it. The seller is the owner of the company and the company owner would like to get as much money for a company as possible. So his goal must be to not just sell planes for the depreciated price they have in the books but to make sure to get some extra. If you sell your company just for the price you have in the books then you lose a lot of money I guess. If the question is how much can you charge for the available slots you have at certain airports, that is the relevant thing. You have slots at airports at hopefully good times of the day, and there you could say 'ok I sell you my planes and I sell you my reputation and I sell you the slots'. That would then give him a hopefully fair price. From a seller's perspective I just see that he want's to sustainably keep the airline on the market and get as much out of it as possible. If we look at Helvetic as an example, Ebner is a professional investor. He has invested in Helvetic to earn money with it, and not to play games. So he's not interested in loosing money, but in making money - so if he sells his airline at a certain time, he will figure out a way to make money with it.

Interviewer: So in another interview the person mentioned that the staff would be a major stumbling block; so that once the deal is announced, the pilots would immediately meet and sign some sort of pact, agreeing to not jeopardize each other's salaries. Which means the cost advantage of the seller basically disappears. How do you perceive this, and what could be a strategy for the seller to lower this risk?

Andreas Wittmer: It's a question of whether the airline buys another airline and keeps it as it is or whether an airline buys another airline and changes the brand to its own and integrates it all. You don't need to integrate, you can just buy the airline and leave it as it is. And just put it optimally in your network and operate the planes accordingly. It doesn't mean that you have to integrate your people at all. You can have a separate entity. As I said, Swiss Global and Swiss International Air Lines are already two airlines, being Crossair and Swissair from the past. They just integrated the brands and they had huge discussions about the salary structures of the former Crossair and Swissair people, the latter earning much more of course. But they were long haul and the other ones short haul, that was the argument. Then they put them into two different entities because they wanted to have different companies and different salaries and didn't want that the former Crossair people suddenly earned twice as much. So they took care of that in a more or less integrated way, but behind there are two different companies, under one brand. And if you take Helvetic as a case you could say ok, we merge it with Swiss Global Air Lines which is the former Crossair. Or you could just say lets keep it as it is, run it as Helvetic. But own it and integrate it better into your network. There's different ways and opportunities of how you integrate. Of course having more brands is more expensive, so there's pro's and con's of course.

11.1.5 Thomas Krutzler, Chief Commercial Officer, People's Air Group

<u>Transcript: Interview with Thomas Krutzler, Chief Commercial Officer and Accountable Manager, People's Air Group</u>

Interviewer:	David Egli, Student IM
Interview partner:	Thomas Krutzler Chief Commercial Officer Accountable Manager People's Air Group
Date:	Wednesday, April 25, 2018
Time and Location:	12:00 People's Air Group Altenrhein Airport
Language:	dialect (de)

Thomas Krutzler: So I will just elaborate a bit on the topic, and maybe you can integrate what I am saying into some of the questions. From my point of view there's the following perspective of consolidation. It is correct that the industry is filled with consolidation, on the other hand one has to say that globally there has never been a time with more airlines. And the numbers are growing. For me, consolidation is rather a step to buy weak airlines at an optimal point in time. Conversely though every year there are more airlines operating (globally, A/N). In Europe there are airline groups like Lufthansa group for example, but then there's also single players like Ryanair, EasyJet, or Wizz Air, ordering planes as if there were no tomorrow. And they will enjoy much more sustainable growth than the airline groups. And that's also Lufthansa Group's raison d'être, that they just cannot organically grow that much anymore without buying up other airlines. Also very important for the European market is the issue of slots. So the issue is securing slots at important locations - Ryanair didn't buy Laudamotion because of fun, but to better manifest their position in Germany. So at some point the slots now owned by

Laudamotion will belong to Ryanair. Otherwise they would never be able to access certain airports due to slot scarcity. So from this perspective, consolidation is ongoing. Concerning small airlines, I rather see three different business models.

1) Would be something like we have, so strongly focused on a niche. In addition to that we are trying to get flying hours through charter flights, but in essence what generates revenue is the niche we are serving. So Altenrhein-Vienna. The advantage for us is that we have the airport that can't be easily served.

2) An example would be Helvetic. So they are relatively dependent on SWISS trough wet-lease but also fly routes on their own, also seasonally. They also do charter and ACMI (Aircraft, Crew, Maintenance, Insurance, A/N). That works usually quite well because through consolidation there's a tendency that the aircraft are getting bigger and bigger, so the growth is generated through capacity. Which means that the lower seat segments between 70 and 110 seats or so is being neglected by the big ones. And that's an opportunity for the small carriers, like us.

3) Third example, when talking about regional airlines, could be Adria Airways. They are almost doing the same as Helvetic but obviously with a different ownership structure. So they are already much more involved with a larger entity. And that means they obviously have much fewer competences and are basically just the contractor.

Interviewer: What do you think about small airlines in Europe? What are their advantages/opportunities and disadvantages/threats?

Thomas Krutzler: It really depends on your business model, and what you are pursuing. It also depends on your ownership structure. I think that with those three pillars on which many small airlines in Europe base their business model on, it makes sense, also from a economic point of view. There are regional carriers that only do ACMI. Which from my point of view is a very difficult business because you never know in advance how many orders you will actually get. So very difficult to calculate, and difficult to predict. An advantage could be the mentioned growth in aircraft size and that regional carriers can step in.

Interviewer: How about the chances of survival for small airlines in Europe/Switzerland? Are they even needed?

Thomas Krutzler: Yes, they are needed. Because I think out of Switzerland it makes perfect sense that routes that aren't necessarily high frequent ones are being served by regional carriers. I also think that the chances of survival then are very high. On the other hand, one has to admit that the Swiss market is one with a very high purchasing power. If you operate as a regional carrier in a low-income country, it can be very hard because the costs per seat are obviously much higher with a smaller aircraft. And if you are in a market with low purchasing power then it's difficult to even cover the costs.

Interviewer: But then also a Skywork is struggling; and I mean Berne isn't really the economic center of Europe. Since you are saying that the chances of survival are high, how do you see the threat of substitution? So the train, or maybe autonomous driving in a couple decades?

Thomas Krutzler: Could obviously happen yes, and substitution too, yes. But I don't think it'll equal the demand for air travel. Flying isn't some form of luxury anymore but rather a means of transportation for the masses. And I also think that developing new train lines is much harder than new air routes, due to infrastructure concerns on the ground. I don't think it's a big risk for a regional carrier. Skywork simply doesn't seem to have a strategy. Now they're trying to operate de-centrally, which is very difficult and which I would not recommend any regional airline.

Interviewer: In Europe, market fragmentation still offers opportunities for small carriers. Do you think the concept of *Peoples*, and the niche market it serves, shelters it to some degree from the big competitive forces at work?

Thomas Krutzler: It also has to do with the general frame conditions - such as the limited length of the runway. Only one airline from this DACH region could land here today, April 25, 2018 - and that's Austrian Airlines with it's Q400. We are operating in a very stable niche, the east-west traffic is here but where we meet competition is towards Zurich. So Winterthur is a hot topic, we've often tried to convince them of the benefits of flying out of ACH. Simply put, if you are unlucky it will take you almost the same time to drive to Zurich Airport from Winterthur as driving to Altenrhein. But here you then have much shorter processes, no waiting in line etc. So that's our advantage. On the other hand, and that is simply a fact, is that a Star Alliance simply has a bargaining power that we as a small carrier can never match. Still we have a lot of regular customers and we have enjoyed quite some growth in the charter area in the last years. So apparently there is a market. And I also see potential for us to further grow in this region. We have also been thinking if it would make sense to collaborate with Austrian Airlines. We have had talks with Austrian - and the result was the following, and there the problems of consolidation become apparent. What passengers we attract from this region and distribute onto the network of Austrian, basically don't fly with SWISS. So the entity that has something against such a collaboration is the Lufthansa Group - mainly SWISS, but ultimately the call came from Frankfurt. So it wasn't Austrian that had something against a collaboration, but SWISS because they want to protect their home market. Apart from that we don't know if it would make sense for us - since on code share connections, the amount of the ticket price we would get for the short trip Altenrhein-Vienna would definitely be much lower than what we can charge now. So I don't see it being absolutely necessary at the moment. And since we only have regional traffic we have a much higher average passenger yield. So in terms of growth we can mainly grow organically through for example larger aircraft. And in this respect we are discussing what kind of equipment we could operate here in Altenrhein, specifically the Embraer E190 E2. Because the flights to Vienna are full. And in the charter more capacity promises more traffic, and with a larger aircraft and larger engines you can fly other, lucrative routes.

Interviewer: An there are obvious limitations here concerning the infrastructure - I mean to extend the runway is impossible, since on one side there's the lake and on the other there's the environmentally protected area.

Thomas Krutzler: True, but we also have opportunities concerning the frame conditions. For example the opening hours - this also has to do with noise abatement. Basically everything that is settled in the Swiss-Austrian bilateral agreements. That limits us very much. Easter Sunday - Airport closed. I mean, you see. So we are tackling those issues, but that takes a lot of time, and it's politically difficult to solve.

Interviewer: Do regulators in Europe differ from other markets (US, Asia) and if so, how?

Thomas Krutzler: I would say the EU regulations on aviation are very strict, so there's basically no other industry that is regulated on such a high level. I recently had to go through all the EASA regulations, and you notice, I mean, these are books full of regulations and requirements. There are 600 people in Köln, doing nothing else than inventing new rules and regulations. And that hinders, to a certain degree, not just us as small airline but the overall market development. An in comparison to the US or Asia, I mean we are definitely not measured the same way. They are not necessarily less restrictive, but more oriented towards competitive markets. Much more open, too. For example the project CES - Single European Skies. The concept or idea is very good since it looks a lot like what the Americans do, but it cannot be implemented in Europe. Because every country still says no, that's mine or this is up to me etc.

Interviewer: What do you think about the impact of consolidation on:

a. Efficiency in terms of margins
b. Prices
c. Diversity of choice

Thomas Krutzler: Well that is really a question of the business model. So generally the price pressures are very high. And there's this example of Zurich - Vienna, formerly also served by Air Berlin, apart from SWISS and Austrian. Star Alliance now has a monopoly on that route, and has flooded it with capacity, you can basically fly there every hour. Now we (Peoples, A/N) also fly to Switzerland, four times a day. What we observed was that prices rose, simply due to the monopoly of Star Alliance. But what we also saw was that the people compare prices much more often now. So the pressure on price will always be there, even if on certain routes there are times of less diversity of choice, such as Vienna - Zurich at the moment. But in the long term, the prices will always be under pressure. This partly then reflects on diversity of choice, as with all the different prices that are being made now, the passenger can select what he wants to pay etc. We as a small carrier obviously don't follow this strategy, we have one price and it includes the entire service, but for the big carriers this makes sense, evidently.

Interviewer: In the airline value chain (below: Porter's value chain), what do you consider as the most important aspect(s) for efficient value generation?

Thomas Krutzler: I would say there are two important aspects. One is the frame conditions. So the political, traffic, and infrastructure conditions. And the other is technology. That's absolutely crucial. Everything else basically follows. So just as an example, the new EMB E190 is much more efficient than its predecessor - completely new technology. So the technological advancement is decisive in remaining competitive. And if the frame conditions bind you, then the best technology will not help you.

Interviewer: Where in this value chain due you think is your advantage as a small carrier? Especially to lower the costs and or gain operational efficiency.

Thomas Krutzler: So if we don't just consider the airline, but the group - the big advantage of us as Peoples group is that our staff is basically ‚multi-functional'. We have people they're first at the check-in, and then switch to the accounting department. Or we have people employed both as cabin and cockpit crew. So our efficiency lies in the HR or staffing function. Marketing and Sales is always a topic, and these days you can have very cheap and efficient marketing. Certain customer retention is important, but equally important is that you make use of the tools that are available today and don't necessarily cost a scandalous amount of money. Service we rather plan on investing in, so the cost gains from that department are not too great. And operation of course also depends on the efficiency of the aircraft etc.

Interviewer: You obviously can't leverage synergies if you are alone - so unlike Lufthansa, who can benefit from group internal logistics etc., you have to organize it all yourself.

Thomas Krutzler: Yes, and of course there are many areas which we cannot handle ourselves because we are simply too small. For example maintenance, which we buy from a supplier that already has this efficiency in-house - for example Lufthansa Group. Or in our case it is Laudamotion.

Interviewer: In light of industry consolidation, do you think it could be beneficial for small airlines to proactively sell themselves on their own terms (from a management point of view - before getting taken over or being pushed out by competition), and if so, why? What could be possible advantages / disadvantages?

Thomas Krutzler: I think that if you have a business model that is economically sustainable, then you are not thinking about selling it. Of course the frame conditions or the business environment can change. If you are very dependent or reliable on other airlines anyway, or already have very close ties to another carrier, then it's probably only a question of time until you get taken over. There the question arises of when would be the optimal point in time to execute such a transaction. It obviously also depends on the fleet, or the assets that you can offer. So if you have old planes then that is already not very attractive. If you have cheap and efficient staff than that is an advantage, because every consolidated group is searching for cheap platforms to put pressure on the expensive ones. So I would definitely not dismiss the possibility.

Interviewer: Just as an example, if I am the management of a small airline and I come to the conclusion that in the long-term I will probably not survive, even though I have a good product and am serving a nice niche. So before holding an auction of some sort, what would you say could be KSFs for me to find a buyer, and to maximize the transaction revenue?

Thomas Krutzler: Definitely tight organization, flat hierarchies, fast decision making and subsequently a favorable cost structure. If you are reliable and have a good service, you have something to show, which helps you to leverage your stand point. Adria Airways would be an example, I mean they've been almost bankrupt for four times or so. Now it belongs to an investor that does nothing else but pretty it up and then sell it again. So the operational history isn't too bright. They've also not had a clear strategy, basically flying around Europe kind of a bit for everyone. In turn of course there are some very smart tactics - basically ruining the airline so you have to start over, but without all the burdens from the past.

Interviewer: Very last question: Would you say that, sooner or later, you anticipate to receive a takeover offer for Peoples? So sooner or later you will face this option anyway.

Thomas Krutzler: Yes I do. In the long-term, definitely. The question is more: a buyer for the entire group or just for the airline. And if I may give a concluding recommendation, then of course to buy the entire group, because it doesn't make sense otherwise (laughs). A large advantage if you are small and independent is also that you are not bound by collective wage agreements. And that is of course a large asset. If you don't have that and someone buys you, then you are still tied to those agreements. And that is our advantage that we have and that we can leverage, or a Helvetic can leverage, or any other small regional carrier on this planet.

11.2 Recent and significant mergers and acquisitions in Europe

Buyer / Merger	Target	Post Transaction	Year	Deal Value		Source
EasyJet	Go Fly	EasyJet	2003	£374 m	€598 m	https://www.telegraph.co.uk/finance/2762800/EasyJet-buys-rival-Go.html / https://www.n-tv.de/archiv/EasyJet-kauft-Go-article127913.html
Ryanair	Buzz	Ryanair	2003	€23.9 m		https://www.theguardian.com/business/2003/jan/31/money.cheapflights
Air France/KLM		separate Brands	2004	€800 m		https://www.theguardian.com/business/2003/oct/17/theairlineindustry
Lufthansa	SWISS	separate Brands	2005	€310 m		http://www.dw.com/en/eu-gives-lufthansa-swiss-merger-go-ahead/a-1640372
Lufthansa	SN Brussels	separate Brands	2006	€65 m		https://www.reuters.com/article/us-lufthansa-m-a/lufthansa-board-approves-brussels-airlines-takeover-idUSKCN11Y1IK
Air Berlin	LTU	Air Berlin	2007	€250 m		http://www.handelsblatt.com/unternehmen/handel-konsumgueter/millionen geschaeft-air-berlin-kauft-ltu/2788206.html
Lufthansa	bmi	separate Brands	2009	£175 m	€227 m	https://www.independent.co.uk/news/business/news/lufthansa-buys-final-20-of-bmi-1796083.html
Lufthansa	Austrian Airlines	separate Brands	2009	€220 m		http://www.dw.com/en/lufthansa-completes-takeover-of-austrian-airlines /a-4623031
British Airways/Iberia		separate Brands (IAG)	2011	£5bn	€6.5bn	https://www.theguardian.com/business/2010/nov/29/british-airways-iberia-agree-merger
IAG	bmi	separate Brands (IAG)	2012	£172.5 m	€223 m	https://www.theguardian.com/business/2012/apr/20/iag-bmi-acquisition-british-airways
IAG	Vueling	separate Brands (IAG)	2013	€123.5 m		http://www.iairgroup.com/phoenix.zhtml?c=240949&p=irol-newsArticle_Print&ID=1809515&highlight
IAG	Aer Lingus	separate Brands (IAG)	2015	€1.5bn		https://www.irishtimes.com/business/transport-and-tourism/aer-lingus-value-soared-by-50-after-purchase-by-iag-1.3319474
IAG	Nikki	separate Brands (IAG)	2017	€20 million		https://www.reuters.com/article/us-iag-niki/ba-owner-iag-to-buy-insolvent-austrian-holiday-airline-niki-idUSKBN1EN1NF
Lufthansa	Air Berlin	Lufthansa	2017	€210 million		https://www.ft.com/content/e453d592-e662-11e7-97e2-916d4fbac0da

11.3 Airlines in Switzerland

Airline	Homebase	Fleet size	Passengers p.a. (2017)	Category	Sources (all accessed on May 21, 2018)
SWISS*	Zurich	83	17m	Mid-sized	• https://www.planespotters.net/airline/Swiss • https://www.swiss.com/corporate/EN/media/newsroom/traffic-reports-archive
Edelweiss	Zurich	15	1.7m	small	• https://www.flyedelweiss.com/de/aboutedelweiss/pages/fleet.aspx • https://www.flyedelweiss.com/de/aboutedelweiss/pages/company.aspx
Helvetic Airways	Zurich	12	2m	small	• https://www.helvetic.com/fleet-and-maintenance • https://www.blick.ch/news/wirtschaft/helvetic-ceo-tobias-pogorevc-ueber-lukrative-spezialauftraege-und-seinen-chef-martin-ebner-sie-koennen-uns-auch-fuer-ihre-hochzeit-chartern-id8132741.html
Skywork	Berne	6	156k	small	• https://www.flyskywork.com/de/unternehmen/profil/flotte • https://www.bernerzeitung.ch/region/bern/Nach-dem-Grounding-investiert-Skywork-Millionen/story/11106040
People's Air Group	St. Gallen Altenrhein	2	100k	Small	• https://peoples.ch/peoples-airline/flotte • https://www.srf.ch/news/regional/ostschweiz/das-unternehmen-schreibt-schwarze-zahlen

*incl. both Swiss International and Swiss Global Air Lines Ltd.