



Codesharing agreements by low-cost carriers: An explorative analysis



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ARTICLE INFO

Article history:

Received 17 May 2013

Received in revised form

18 August 2014

Accepted 7 October 2014

Available online 25 October 2014

ABSTRACT

In this paper, we present an explorative analysis related to the involvement of low-cost carriers (LCCs) in codesharing agreements. Our goals are to evaluate the diffusion of the phenomenon across countries, and to identify the determining features of companies with regards to the codesharing propensity of LCCs. We analyzed the worldwide scheduling of LCCs in 2011, revealing that one-third of LCCs were involved in codesharing arrangements in 2011. Yet, only 25% of LCCs are involved in codesharing with carriers to whom they are not hierarchically linked. The spread of this phenomenon varied by geographical area, with LCCs in Europe, Australia–New Zealand, Asia, and North America being most likely to codeshare. The airline size, the hybridization of the carrier's business model and an airline network concentration affect the likelihood to codeshare.

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1. Introduction

Since the 1980s, the airline industry has been widely interested in *codesharing*: marketing arrangements in which multiple carriers share airline designation codes for identifying airlines on passenger tickets, computer reservation systems (CRSs), airline guides, and airport information boards. Through these agreements, airlines share their resources, such that all of the marketing, booking/ticketing, and baggage-handling procedures are run as though by one airline. These agreements provide their participants with a marketing edge and efficiency, thanks to a listing priority in the CRS and the rationalization of resources.

Until 2002, codesharing agreements only concerned traditional carriers, mostly those involved in global airline alliances. In fact, because of its peculiar point-to-point network structure, the traditional low-cost business model does not contemplate the exploitation of any kind of alliance. There also seems to be an inherent conflict between the complexity of the organization of codesharing agreements and the orientation of low-cost carriers (LCCs) towards simplification and reduced transaction costs. However, in 2002, Virgin Blue became the first LCC to sign a

codesharing agreement. Recently, some other LCCs, including Southwest Airlines, have followed its example.

The literature lacks an extensive analysis of the spread of codesharing agreements by LCCs. In this paper, our goal is to evaluate the breadth of the codesharing phenomenon and the peculiarities of codesharing involving LCCs. This paper fills the literature gap by providing an explorative analysis of the involvement of LCCs worldwide in codesharing in 2011. The main objectives are to identify which carriers codeshare and identifying how airlines characteristics affect codesharing practices.

The paper is structured as follows. Section 2 provides a description of benefits of codesharing agreements. Section 3 describes the features of the traditional low cost business model, the traditional attitude towards codesharing agreements by LCCs, the recent phenomenon of low cost business model hybridization and the new approach to partnerships. Section 4 introduces the variables exploited in the analysis whilst Section 5 describes the sample. Section 6 presents a descriptive statistical analysis that compares LCCs involved in codesharing and LCCs not involved. This section also presents the findings of three probit model estimations that look for the airline characteristics affecting the decision to codeshare. The last section reports our concluding remarks.

2. Background on codesharing agreements

Strategic partnerships are cooperative arrangements among firms involving resource sharing by autonomous organizations for the joint accomplishment of goals (Parkhe, 1991). Cooperation is

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commonplace in the airline industry and can take different forms, ranging from simple codesharing agreements to equity swaps, management agreements, and joint governance arrangements. Partnerships are the airlines' reply to the demand of transport globalization. For a single airline, it is almost impossible to create a truly global network in the context of bilateral air-service agreements and foreign ownership restrictions (Oum and Zhang, 1997; Park and Zhang, 1998). As in other industries, players in the airline industry have five generic reasons for entering cooperative arrangements: to achieve economies of scale, to gain access to other firm's assets, to share (and, thereby, reduce) risk, to help shape the market, and to reach the market faster. In the airline industry, a further reason—survival—leads carriers to join cooperative arrangements (Bennett, 1997).

The most diffused partnership is codesharing. Since 1967, when the agreement between Henson Aviation and Allegheny Airlines was signed, codesharing has become a common practice in the airline industry. The phenomenon has increased particularly with the development of the global airline strategic alliance (TRB, 1999). Codesharing in the airline industry is a reciprocal agreement through multiple airlines whereby the carrier operating a given flight allows other airlines to market this flight and issue tickets for it as if they were operating the flight themselves. These other carriers add their own carrier designator code and flight number onto that of the operating carrier. Through this arrangement, the airline that actually operates the flight—the one providing the aircraft, crew, and ground handling—is called the *operating carrier*. Companies that sell tickets for that flight but do not actually operate it are called *marketing carriers*.

Codesharing arrangements provide important advantages. First, they give the carrier a marketing edge by allowing it to provide seamless travel through airports and preferred traffic lanes relative to interline connections. CRSs generally display these flights before listing interline connections (Bamberger et al., 2004). Second, such cooperative arrangements may enhance efficiency by allowing airlines to rationalize their network structure and exploit economies of scale, density, and scope. In particular, they address the uncertainty of transport demand by facilitating the adjustment of seat supply. Third, these arrangements allow the expansion of airline networks and flight frequency (Oum et al., 1996). However, codesharing is not costless for carriers. Setting up these arrangements requires negotiation, coordination, and integration of the airlines' operations. These aspects could reduce an airline's willingness to sign these agreements or, at least, make the process more difficult.

3. LCCs, hybridization, and codesharing

LCCs first emerged in the USA, followed by the EU and the rest of the world, after industry deregulation (Francis et al., 2006). Policy changes facilitated entry into the air transport industry and increased the competition level, such that a new airline business model was needed. As the pioneer of LCCs, Southwest Airlines laid the foundations for a new strategy based on short-haul point-to-point service, operational effectiveness through the simplification of services and processes, and revenue management through dynamic pricing strategies (Gillen and Lall, 2004; Malighetti et al., 2009). Factors that contribute to lowered operating costs include the lack of connecting flights and “frills,” ticketless travel, direct booking, open-seating, provision of only one class of service, standardized equipment, and the exploitation of small or less-congested airports. As a result of their lower operating costs, LCCs can offer lower fares than incumbents (Doganis, 2001) and scheduled services to low-density routes (de Wit and Zuidberg, 2012). In principle, the approach taken by LCCs does not provoke head-to-

head competition with other carriers (Gillen and Lall, 2004), as LCCs generate new demand and attract passengers from other transport modes by serving routes that are not directly operated by network carriers (i.e., they usually open new markets).

In recent years, the market penetration of LCCs has increased worldwide. LCCs, especially first movers, continue to experience traffic growth and increased market share. Their above-average financial performance has attracted the entry of many carriers adopting the original low-cost model (Alamdari and Fagan, 2005). However, the ability of LCCs to stimulate demand is running out, and many markets seem to be at or near the saturation point (Binggeli and Pomepo, 2005). Moreover, LCCs are beginning to experience direct competition on their routes from other LCCs (Malighetti et al., 2013). As LCCs have grown, they have increasingly overlapped with network carrier markets (Morrell, 2005). As a result, network carriers have begun to emulate the best features of their low-cost competitors: they have cut their costs. Charter airlines, which are typically characterized by a lean cost structure, have also entered the typical low-cost markets, which has led to competition between the charter airlines and low-cost operators. Consequently, LCCs are being affected by a greater competitive pressure, which requires them to follow a differentiation strategy other than a simple cost-leadership strategy (Alamdari and Fagan, 2005).

To differentiate themselves from other LCCs, some low-cost operators are adopting different business models that include, for instance, shifting to primary airports, starting hubbing activities, providing meals and other in-flight services, and entering alliances (de Wit and Zuidberg, 2012). Recently, some airlines have undergone a hybridization process, with LCCs adopting some features of full-service network airlines (Klophaus et al., 2012) and full-service network carriers and charter airlines adopting some features of LCCs. Hence, today, LCCs can be classified into different types, as suggested by Francis et al. (2006): namely, Southwest copycats, subsidiaries, cost-cutters, and diversified charter carriers. Southwest copycats are set up in accordance with the traditional low-cost business model introduced by Southwest airlines. Subsidiaries are LCCs that are set up as subsidiaries of long-established major airlines. Cost cutters are traditional airlines that have cut their operating costs, particularly by rationalizing their fleets. Diversified charter carriers are low-cost subsidiaries developed by charter airlines.

Thus, there has been a clear deviation from the traditional low-cost business model. In particular, since 2002, we can observe a different attitude towards partnerships and alliances. LCCs have begun to exploit codesharing agreements, even though codesharing goes against the core concepts of the pure low-cost model and can be expensive and time-consuming to implement. The features of the traditional low-cost business model, especially its use of a point-to-point network, short-haul flights, and direct-booking practices, make the advantages provided by codesharing (e.g., seamless travel and marketing edge on the CRS system) less relevant for low-cost operators. Moreover, codesharing airlines must make technological investments to allow coordination among the partners' operations, back-office functions, and transfer facilities, which can discourage codesharing by LCCs. Nevertheless, several LCCs seem to be attracted by these practices. In 2002, Virgin Blue signed a one-way block-space arrangement with United Airlines. In 2009, Gol Airlines had 25 interline partners. Many other LCCs are exploring the possibility of codesharing and experimenting with new models of codesharing (Flottau et al., 2009; Kerry, 2009; Sobie, 2009). However, other carriers, such as Ryanair, believe that it makes no sense to codeshare because it implies higher operation costs.

To the best of our knowledge, few scholars have examined codesharing practices by LCCs. Du et al. (2008) examined the

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