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The effect of joint ventures on airline competition: the case of American airlines, British airways and Iberia joint business

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Abstract

Regulatory obstacles have led international airlines to make extensive cooperation in the provision of service. The global airline alliances that link U.S. airlines to members in other states is the most visible form of cooperation. Moreover, when the alliance members obtain antitrust immunity, they can determine fares for interline trips that were not possible under traditional pricing arrangements. This research attempts to explain the effect of BA, AA and IB joint venture on transatlantic competition.

Paired samples t-test results indicate that there is no significant difference in AA's economy airfare after the introduction of joint venture. Similarly, there is no significant difference in AA's business airfare. As for BA, the picture is vice versa in terms of economy airfare. There is a significant difference in BA's economy airfare. On the other hand, there is no significant difference in BA's business airfare.

Keywords: Joint ventures, Airline competition, Airline joint venture drivers

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1. Introduction

Globalization in most industry sectors, the fall of the eastern block, the improvement of living standards of the most part of the world population and the limitation of widespread war have all made air travel more affordable and accessible to the average person. People have been using airplanes to meet their different needs such as business, visit to friends and relatives or tourism. Therefore, the air transport service has turned from a luxury service to service directly related to the current way of life. The high demand has led to the quest for cheaper fares as well as to an ever-spreading network. The answer to this demand came from the evolving international economic conditions which have led to a full deregulation of the air transport industry, in certain areas of the world (Iatrou, 2004).

As international airline traffic has increased in recent decades, international airlines have made extensive cooperation in the provision of service. This cooperation aims to get over regulatory obstacles that hinder any one airline from extensively enlarging its international route network. The international airline alliances that connect U.S. airlines to members in other states is the most visible form of cooperation. These alliances provide the international passenger with a seamless travel experience by eliminating some of the troubles of a traditional multicarrier trip. Gate

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proximity at hub airports along with schedule coordination by the alliance members facilitates passenger connections between the airlines. Moreover, when the alliance members obtain antitrust immunity, they can cooperate on pricing. Thanks to immunity, the members can team up to determine fares for interline trips that was unlikely under traditional pricing arrangements (Brueckner, 2003).

This research is focusing on quantifying the impact of cooperation on international airfares. For this purpose, the effect of British Airways (BA), American Airlines (AA) and Iberia (IB) joint venture on transatlantic airfares will be examined to determine whether there is a significant change in transatlantic airfares after joint venture was formed.

2. Literature Review

2.1. Theories behind Formation of Joint Ventures

A transaction cost explanation for joint ventures deal with the question of how a company needs to form its boundary activities with other firms. Williamson (1985) argues that companies decide how to transact according to the criterion of minimizing the sum of transaction and production costs. Other explanation for the use of joint ventures is strategic behaviour theory. Strategic behaviour presumes that companies transact by the aim which maximizes profits through enhancing a firm's competitive position against competitors (Kawagoe, 2008). The main motivation behind joint venture formation is the strategic behaviour to prevent entry of rivals. Vickers (1985) examines joint ventures in research as a method to block entry through pre-emptive patenting.

2.2. Motivations Leading to Airline Joint Venture Formation

2.2.1. Overcoming Regulatory Constraints

All commercial aspects of international air transport have been governed by bilateral air service agreements since the 1944 Chicago Convention. Each international carrier deals with a complex web of bilateral agreements signed by its home country. The existence of the bilateral agreements has substantially limited the freedom of individual scheduled carriers, and has constrained competition in the international air transport industry. Facing these restrictions, entering into joint ventures is the major means for international airlines to obtain access to new markets, and to offer new services (Wang, 2002).

Since the increasing privatization of airlines in Europe and the deregulation of the US airline market, the desire to expand route networks internationally has increased competition between carriers. However, existing regulatory policies that limit the takeover and use of foreign resources pose challenges to international air travel.

Although there are examples of firms holding equity stakes in international airlines, most governments do not allow complete foreign ownership of domestic carriers and airport facilities. Therefore, alliances become an essential recourse for carriers to expand internationally. The industry has seen the formation of several alliances between airlines, especially during the 1990s. Estimates show that more than 80 per cent of global airlines conducted some form of alliance in 2000 (Lazzarini, 2007).

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