



# RE-THINKING AIR PROGRAMS

## Merger Could Prompt Need For New Airline Contracting Strategy

**F**aced with the prospect of another merger of major airline carriers, about half of 195 travel buyers surveyed February 28-March 21 by The BTN Group and Travel and Transport said the move would force them to develop a new airline contracting strategy. Among the largest buyers with air spend of more than \$25 million a year, nearly 80 percent cited the need for a new strategy as they detailed the impact the proposed American Airlines-US Airways union would have on their program.

### > THE LATEST MERGER PROPOSAL

On February 14, 2013, the parent companies of American Airlines and US Airways, the nation's third and fifth largest carriers, respectively, announced an \$11 billion merger. Since approved by the court overseeing American's bankruptcy, the merger, if approved by regulators and shareholders, would make the combined new American Airlines brand the nation's largest with 25 percent of domestic marketshare, according to The Buckingham Research Group, based on data from Diio Mi. The merged entity would be based in Dallas and headed by US Airways CEO Doug Parker with AA CEO Tom Horton serving as non-executive chairman as well as representative to the Oneworld alliance.

The merged entity plans to align with Oneworld, which American helped found. Factoring US Airways' withdrawal from the Star Alliance, airline executives told investors that the 8 percentage point realignment would boost Oneworld's global marketshare to 34 percent and reduce Star's to 36 percent with the Sky Team unchanged at 30 percent. Horton noted that Oneworld would be further strengthened by the March decision of TAM, Brazil's biggest carrier, to join Oneworld.

If the merger is approved, the nation's top four carriers forged through the latest rounds of airline mergers—the new American/US Airways, Delta/Northwest, United/Continental and Southwest/AirTran—would control 80 percent of domestic marketshare. Merger critics argue that such control could lead to higher fares and fewer routes.

“Having four carriers own 80 percent marketshare sounds a bit scary from

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**LONG-TERM CONCERNS ABOUT CONTINUED AIRLINE CONSOLIDATION**

Long-Term 2014 and beyond

Fewer routes	88%
Reduced negotiating leverage	86%
Loss of frequent flyer perks, status	84%
Higher fares	82%
Reduced seat capacity	80%
Booking system changes	60%
Service level issues during migration	31%

Source: BTN Group/Travel and Transport survey of 195 travel buyers, Feb. 28-March 21, 2013; buyers could select more than one concern

a pricing perspective,” Travel and Transport executive vice president and CFO Kevin O’Malley acknowledged. “But as long as the carriers continue to overlap and compete in most city pairs it provides a healthy airline industry.”

> **BUYER CONCERNS ON CONSOLIDATION**

Short-term, the majority of buyers surveyed by The BTN Group/Travel and Transport, said they were most concerned about service-level issues during migration, higher fares, reduced seat capacity and booking system changes. Others also noted their concerns about “reduced soft-dollar benefits, more restrictions, further fare unbundling and code-share disruptions.”

Longer-term, buyers said they were most concerned about fewer routes, reduced negotiating leverage, loss of frequent flyer perks and status in a larger program and higher fares.

> **PROGRAM IMPACT**

About one-quarter of those surveyed said they expected no impact on their domestic airline contract negotiation should the proposed merger be approved. In addition to the 50 percent who cited the need for a new contracting strategy, 19 percent said they expected the need for fewer domestic negotiated contracts

while 16 percent expected to need more domestic negotiated contracts should the merger be completed.

Regardless of concerns, TCG Consulting partner and air practice director Barry Rogers said historically they rarely delay sourcing initiatives. “For the past ten years, there has been something going on that could have delayed a client’s sourcing process, such as bankruptcies, mergers, etc. As most companies contract for two-year periods, and it will likely be close to that before AA/US can realistically contract together, anyone contracting now has to deal with them as they are,” the travel management consultant added.

In testimony filed March 19 with the Senate Judiciary Committee’s Subcommittee on Antitrust, Competition Policy and Consumer Rights, US Airways’ Parker and AA’s Horton noted that the merger would lead to “more than 6,700 flights daily to more than 330 destinations in over 50 countries, but result in overlaps on only 12 of the over 900 non-stop airport to airport routes the new carrier would serve. Most of the overlap routes connect our existing hubs, where there is significant competition. With the expiration in the fall of 2014 of the Wright Amendment, which limits flights out of Dallas’ Love Field, non-stop competition will be present or added on nearly all airport pair overlaps. This limited number of overlaps compares favorably with the most recent large airline mergers of Delta/Northwest, United/Continental and Southwest/



**AIR SOURCING STRATEGY**

Travel and Transport, the fifth largest travel management company in the United States, specializes in corporate travel management along with group and meeting travel services. A leader in online travel technology, Travel and Transport provides companies with innovative data solutions and reporting tools, including web-based, pre-and post-trip reporting and mobile access to data. The TMC also offers a Partner Solutions Group to provide companies with the tools, expertise and support to effectively manage air, hotel and car spend. Travel and Transport Executive Vice President and CFO Kevin O’Malley provided more insight on the group.

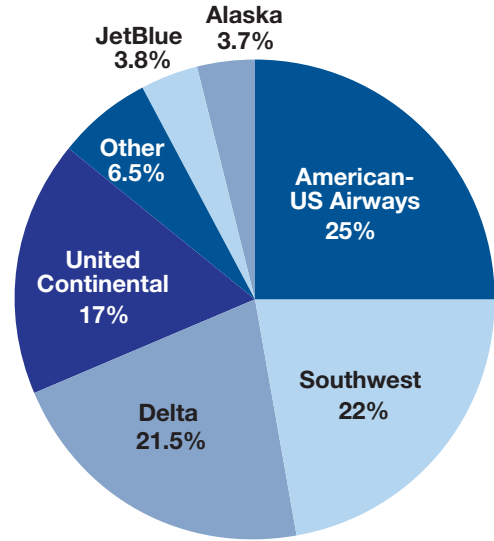
**Q: What is the scope of your Partner Solutions Group?**  
**A:** Partner Solutions started about seven years ago. It grew from one person initially to 16 now. Ten are focused on hotel consulting, three on air consulting and others on car rental, black car and miscellaneous projects that clients request. Our consultants assist with engagements, most with Travel and Transport customers, but some with non-customers too. We might run the complete air, car or hotel request for proposal process, do contract reviews, provide perspectives on bids received in a client-led RFP or wrap up contract negotiations for a client.

**Q: What do clients typically need in air services?**  
**A:** Half the time our Partner Solutions team is leading the RFP process from beginning to end. The other half, the client wants our team to help them analyze proposals received and what they really mean to that client. There’s a lot of complexity in today’s air contracting world, based on classes of service and various ways airlines operate. We’ll do indepth analysis by city pair. A 15 percent discount may sound really good, but you have to slice it down to the nth degree to understand the total picture and what the overall deal would really mean to a specific company and its unique travelers and patterns.

**Q: What trends are you seeing in the air contracting practice?**  
**A:** The number of engagements we’ve been pulled into over the past three years has increased significantly because of the complexity of sourcing. In analyzing contracts, often we advise that various elements that have traditionally been in contracts are removed or adjusted. For example, a lot of airlines ask for city-pair specific marketshare goals. In the past some clients entered into those contracts a little blindly, based on their own corporate data. As airlines are merging, data has become more available and the ability to get at fair marketshare has become more readily available, we’re able to help clients negotiate more realistic goals. We buy external data and highlight what is not realistic.

**COMBINED AMERICAN-US AIRWAYS WOULD TOP MARKETSHARE**

Based On 2013 U.S. Domestic Seats



Source: The Buckingham Research Group based on data from Diio Mi

AirTran, all of which received Justice Department clearance because the combination of those carriers created substantial consumer benefits with minimal competitive overlap,” according to the testimony.

> **ALLIANCE SHIFTS**

Airline executives claim the merger won’t result in loss of service. In an analysis, TCG Consulting said the alliance shift likely would prompt US Airways to disengage from the Star Alliance and its code share with United Airlines. “Based on analysis done by TCG at the time of the merger announcement, US Airways has its code on 1,912 flights operated by United and United has its code on 1,400 flights operated by US Airways. As a result, we can expect United to look at increasing its flights in certain markets, particularly from US Airways’ hubs at Charlotte and Philadelphia and the new American increasing its flights in markets now operated by United,” stated the TCG report.

American and US Airways noted that they quickly plan to win corporate share lost to competitors in recent years. But TCG consultants noted that US Air-

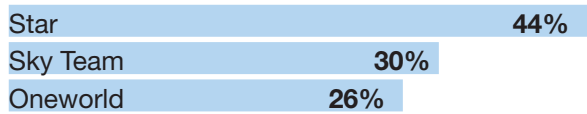


ways’ extraction from the Star Alliance and United program could “add a complication to the process.”

In Senate hearing testimony March 19, Parker and Horton noted that the “combined airlines, especially due to improved East Coast service,” would make Oneworld “more attractive to consumers and therefore more competitive.”

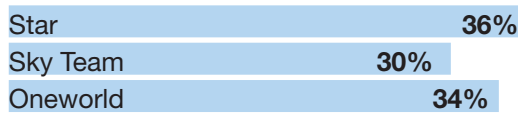
**PRE-MERGER**

US-to-World ASM Share



**POST-MERGER**

US-to-World ASM Share



Source: Diio 2013 published schedules as of January 25, 2013

**> CAPACITY CONTROLLING PRICING**

More than the mergers themselves, O’Malley noted that “airline discipline with seating capacity will do a lot more to control pricing in the long run. As they’ve come out of bankruptcy—particularly in the last two to three years—airlines have exercised a lot more discipline on capacity. As long as the four primary carriers, assuming the merger is completed, continue to exercise that discipline, I think we will see their ability to control pricing remain strong,” he added.

Airline analyst Daniel McKenzie of The Buckingham Research Group echoed O’Malley’s view in an April 3, 2013, research note. “Airline revenue initiatives help, but it’s the industry’s collective willingness—or not—to restructure capacity in response to the demand backdrop that remains the #1 pricing driver for airlines,” he said.

“Capacity has come out of the industry and is mostly staying out,” McKenzie said. System capacity in the summer of 2013 is 9 percent smaller than in 2007, “the last year of industry profitability in the last cycle,”

McKenzie noted. “Despite aggressive growth by JetBlue, Spirit and Virgin America, there are still 21 million fewer seats available for sales in global distribution systems domestically versus in 2007, driven in part by the exit of a number of airlines,” he continued.

**> RECOMMENDATIONS**

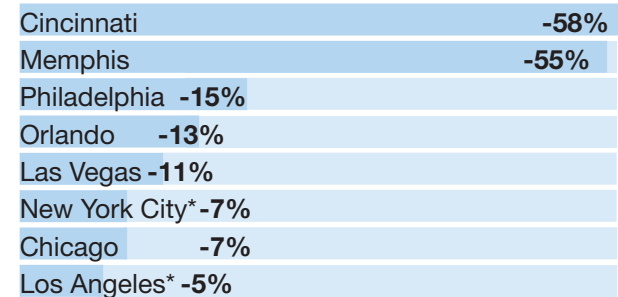
“Companies looking at sourcing in late 2013 or early 2014, for which American Airlines and/or US Airways, are significant carriers would probably want to be talking with AA and/or US Airways to see specifically what they’re doing, and what the timing looks like for integrated contracting,” Rogers advised.

Travel and Transport’s O’Malley noted that “more coverage means that more than likely the national distributorships will wait to be able to contract with United, Delta and the new American and make them all happy. Buyers will need to make tough choices.”

**BIGGEST CAPACITY CUTS**

By Number Of Seats Eliminated From Each Market

CHANGE Q2 2013 V. 2008



\*All 5 airports in both markets  
Source: Diio Mi and Buckingham Research



For more information about how Travel and Transport can help devise a new air sourcing strategy, visit [www.travelandtransport.com](http://www.travelandtransport.com).