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Buying airline partners: Parallels between Swissair and Etihad Airways

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Abstract

During the 1990s Swissair adopted an alliance business model through the purchase of minority stakes in a number of carriers. Etihad Airways followed a similar approach from 2011 through until the onset of the Covid-19 pandemic, building equity stakes in a range of carriers in Europe, and the Indo-Pacific region. This paper uses comparative case study analysis, and argues that making substantial equity investments in second-tier (often loss-making or debt-laden) airlines increases risk without offsetting benefits. Viable alternatives to equity stakes exist including code-sharing, strategic partnerships and global alliance membership, that generate equally attractive customer perceived benefits, while avoiding the need for financial capital being applied less efficiently. Furthermore, this paper argues that profitability is not directly linked to alliance membership. Return on investment is arguably even harder to achieve when the alliance is based on a small selection of second tier carriers. The paper concludes with several future scenarios that could play out for airlines contemplating equity-based alliances, and identifies membership of one of the larger global alliances as the probable better option.

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1. Introduction

This paper aims to unpack and assess key historical parallels and differences between the equity stakes strategies of both Swissair and Etihad Airways by employing a comparative case study approach. Following a path taken by Swissair in the 1990s, Abu Dhabi-based Etihad Airways pursued a number of equity investments in other carriers starting in 2011 with Air Berlin, then Virgin Australia, and the rebranded Air Serbia (formerly JAT Airways). Etihad's

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initial 49% stake in Air Serbia was more substantial than its stakes in Germany's Air Berlin (29%), Air Seychelles (40%) and India's Jet Airways (24%) (Bhojrul, 2014). Further shareholdings included Virgin Australia (20%) and a minor stake in Irish flag carrier Aer Lingus (3%). Etihad also took a 33% share of the Switzerland-based regional carrier Darwin Air and rebranded it 'Etihad Regional' (CAPA, 2013). There was little profitability amongst these airlines, and they were burdened by debt. The scattering of equity stakes with airlines in several European countries, and widely varying shareholdings, raises questions both about the underlying strategy, and the possibility that much or all of the benefit could have been gained through more conventional alliance membership.

Strategy research offers little to suggest that equity stakes produce superior outcomes from strategic airline partnerships (Gudmundsson & Lechner, 2006; Iatrou & Oretti, 2007; Lazzarini, 2007; Vasigh, Fleming, & Tacker, 2013). Etihad's equity alliance approach reflected a strategy, according to its then CEO James Hogan, that was he argued "part of how I differentiate and build a network to compete" with Gulf rivals (Kingsley-Jones, 2013b, para. 4). Comparisons with Switzerland's former national carrier Swissair and its failed 'hunter strategy' are hard to avoid. That strategy saw Swissair invest heavily in a range of second-tier European airlines including Belgium's former flag carrier Sabena. These equity investments left Swissair exposed to its partners' financial woes. Swissair collapsed in October 2001 (Knorr & Arndt, 2004).

There is no likely danger of state-supported Etihad going bankrupt, but its now abandoned strategy of minor equity stakes in multiple regional partners is worthy of closer scrutiny. Few questioned (until the very end) that Swissair the so-called 'flying bank' would ever become entangled in a financial web that would see it consumed (Hermann & Rammal, 2010). Etihad's CEO at the time of these equity stakes, James Hogan, was quick to defend his equity strategy, arguing: "We're not a bank. We're not here just to create a collection of brands. We're here to create an equity alliance strategy where we all win" (Kingsley-Jones, 2013b, para. 19). Swissair would arguably have made the same defence of its strategy. Profitability is elusive at the best of times in the airline industry. This raises questions around narrow equity-based partnering when other alliance and commercial options exist. Buying an alliance expends capital, and management time and focus, on an activity than can be achieved through commercial negotiation.

2. Methodology

Comparing and contrasting two airlines from different time periods – not to mention separate geographical regions – is an exercise fraught with challenges, though still capable of generating valuable and meaningful key insights if approached pragmatically and carefully. History rarely predicts the future, but the failures of the past hold important and noteworthy lessons. Etihad is not Swissair; it is geographically, economically, politically and culturally different. Short-haul markets are now shaped by large low cost carriers (LCCs) in Europe, Asia and North America. Nevertheless, comparing and contrasting a historical case study with a contemporary one may offer valuable insights that reveal core issues. chiefly:

- Past experiences provide cautionary tales, helping to shape and sharpen business decisions, strategies and risk assessments;
- Historical cases demonstrate that others have tried and have not always succeeded when faced with similar strategic options, and why this is the case; and
- History helps to identify key challenges and pitfalls, thus encouraging business cases and supporting arguments to be well devised.

The use of case studies to analyse both airlines and the airline industry is a well-established tradition throughout the academic literature. Analysis of airline failure, including the history leading up to an airline's collapse is not uncommon; for example, Leiper (2002) investigated why Ansett Airlines failed in September 2001. Multiple case studies are also common in the literature, with de Man, Roijackers, and de Graauw (2010) looking at "the virtual joint venture" between KLM and Northwest Airlines that lasted for more than a decade (p. 176). Research has also looked at LCCs, including AirAsia and the surrounding historical context of the low cost model in Asia (Shuk-Ching Poon & Waring, 2010). Other studies have compared and contrasted a LCC with a full service carrier (FSC); for example, Ryanair with Aer Lingus (Kangis & O'Reilly, 2003). Comparative case study analysis has also been conducted utilising two FSCs as the basis, including Qantas and Aer Lingus (Oxenbridge, Wallace, White, Tiernan, & Lansbury, 2010).

3. Results

3.1. Swissair fleet

As a first step in setting the scene, the fleet of Swissair and then Etihad Airways are detailed to gain a better appreciation of the size and fleet composition of each airline. Founded in 1931 Swissair was renowned for its aircraft purchases from the leading manufacturers of the time; for example, it was an early adopter of the DC2 and DC3 in the 1930s. It entered the jet age with the Sud Aviation Caravelle in 1960 for its European network, and then introduced the Douglas DC8 and Convair C990 for inter-continental routes. By the start of the period being examined in this paper, Swissair had a mixed fleet of narrow and wide body aircraft with the Fokker 100 and MD 80 (soon replaced by Airbus A320 family) forming the backbone of its regional and European fleet, alongside the A310 operating routes to the Middle East. For longer distance international routes, the airline had been an early adopter of the 747 (1971) and DC10 (1973) aircraft, with the MD11 entering service in 1991 replacing the older wide bodied types. By the late 1990s Swissair had started operating the twin engined A330.

As shown in Figure 1, during the period from 1990 to 2001 Swissair maintained a fleet of between 55 and 75 aircraft, with a proportion of narrow body (NB) varying between 52% to 60% of total fleet, and shown in blue – wide body (WB) aircraft are shown in red.

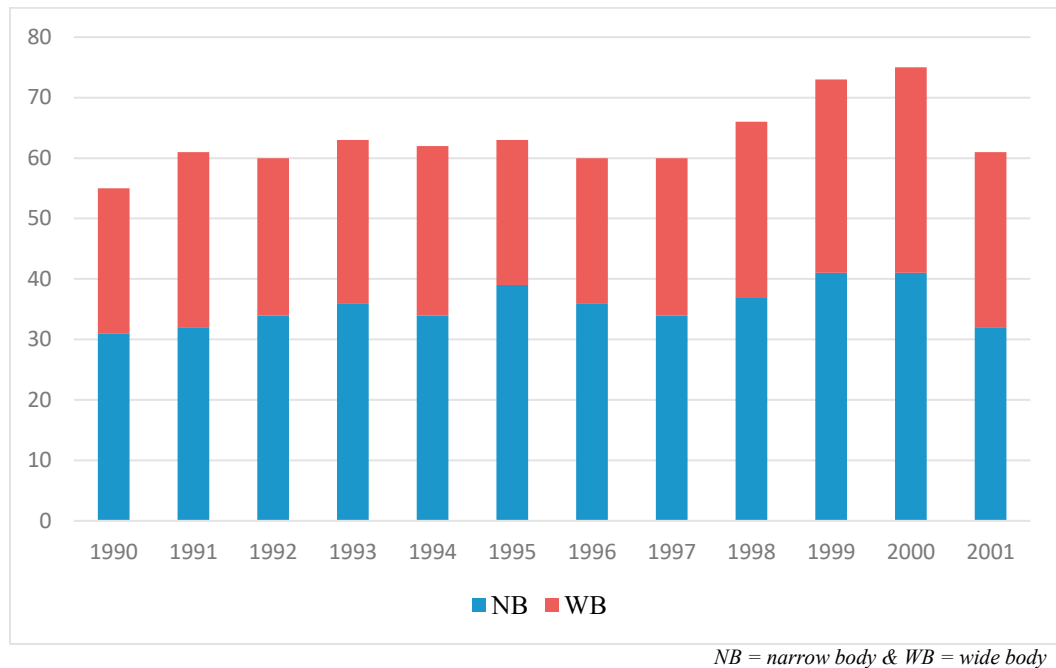
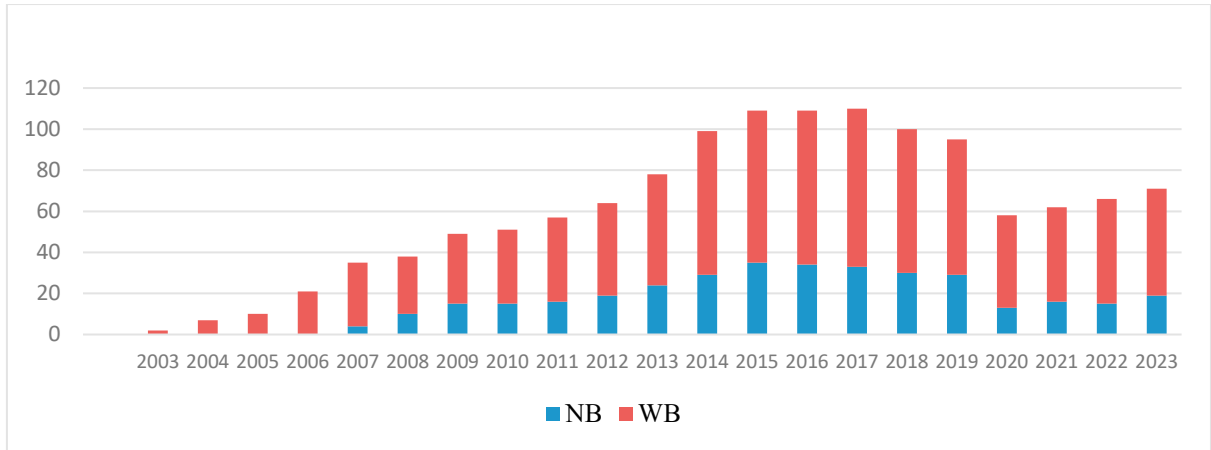


Fig. 1. Swissair Fleet Mix. Source: Compiled using data from Cirium, 2023

3.2. Etihad Airways fleet

Etihad Airways was founded in 2003 and started operating with A330 aircraft, and for the first four years of operation flew A330 and A340 aircraft. However, unlike its UAE neighbour Emirates, who by 1995 had stopped flying narrow body aircraft (B727s) (Hengi, 2000), Etihad saw a benefit of having single aisle aircraft in their fleet to operate thinner routes to feed the Abu Dhabi hub, and ordered A320 aircraft in 2005. Over the next 10 years the airline increased its fleet both in terms of wide bodied aircraft and narrow bodied types.

As shown in Figure 2, Etihad's fleet grew steadily with deliveries of wide bodies (including at various times A330s/A340s/B767s/B777s/B787s and A380s), and narrow bodies (A320s family) over the years to peak at 110 aircraft in 2017. At this point, the proportion of narrow bodies was 30% of the total fleet for the airline. Since then, with the change in leadership and strategy, the fleet was reduced in 2019 to 95, with the impact of Covid-19 the fleet reduced dramatically to just 58 aircraft in 2020. The fleet has grown since then, and with the reintroduction of the A380 on the London Heathrow route in July 2023 it will be up to 71 aircraft, of which 27% are narrow bodied.



NB = narrow body & WB = wide body

Fig. 2. Etihad Airways Fleet Mix. Source: Compiled using data from Cirium, 2023

3.3. Similarities and differences

When comparing Swissair and Etihad in terms of fleet composition it can be seen that there are some similarities in terms of operating a mix of narrow and wide bodied types. They both operated the largest aircraft available in the market at that time in the B747-300 and A380 respectively, and flew them on lucrative long haul routes offering passengers a mix of cabin classes including luxurious first class. They also both operated smaller wide bodies on a mix of routes matching supply to demand for both short range and long range flights. For shorter and thinner routes they both flew different members of the Airbus A320 family, which alongside operating the A330, gave operational efficiencies in terms of cross crew qualification benefits, and also savings in terms of maintenance and engineering outlay.

However, it should be acknowledged that there were differences between the airlines in that Swissair had a more dense short/medium haul network in its European routes, which meant that the narrow bodied fleet was a larger proportion of the total fleet compared to Etihad. In terms of fleet size, Etihad grew to a larger fleet than Swissair ever operated; but interestingly, by 2023 the total for Etihad is at a level similar to Swissair. Evidently, both airlines ambitions to be global players, spurred on in part by the apparent success of regional rivals, proved too challenging to ultimately realise (to date for Etihad at least). For instance, to make it into the top 10 biggest airlines in the world based on wide body fleet size (along with international destinations and continents served), an airline according to Ellis and Leib (2021) requires about 100 wide bodied aircraft, 90 plus international destinations, and five or six continents served; Etihad in 2019 was situated in 20th position using these metrics.

3.4. Airline alliances past and present

In a similar way that a mixed fleet helped both Swissair and Etihad maintain a more flexible global network, so too partnerships, code shares, alliances and most notably equity stakes allowed both airlines to extend their global reach. Alliances are nothing new in the airline industry, dating back as far as the 1930s. Even so, it was not until 1989 that “the first truly global alliance was formed” when Swissair teamed-up with Singapore Airlines and Delta Air Lines to

form Global Excellence, which included a mutual 5% equity stake (Iatrou & Oretti, 2007, p. 25). The 1990s was a decade of ever shifting and changing airline alliances as mainly US and European carriers sought to capitalise of increasing liberalisation across the North Atlantic. Legacy network carriers in the US have now consolidated into three big groups around American Airlines, United Airlines and Delta Air Lines; while three big flag carrier groupings dominate in Europe (Air France/KLM, the Lufthansa Group & International Airlines Group or IAG; BA/Iberia). Today three big global airline alliances, and their anchor members in the US and EU, dominate the industry, and have done so for well over two decades; Star Alliance (est. 1997), oneworld (est. 1999) and SkyTeam (est. 2000).

This being stated, commercial agreements are also able to achieve meaningful partnerships, and often with less financial exposure than equity stakes. As Iatrou and Oretti (2007) observed nearly two decades ago: “It seems that airlines have come to realise that they can work together without having to buy one another’s stakes” (p. 79). Both Swissair and Etihad opted for deeper relationships with a view that such financial commitments would generate greater relationship strength and longevity.

The widely held view persists that the global airline alliances formed, and indeed continue today, because government restrictions prevent most non-European airlines from consolidating via cross border mergers or acquisitions (Quest, 2012). In fact, as Iatrou and Oretti (2007) pointed out, alliances, mergers and acquisitions are all likely to coexist into the foreseeable future irrespective of the direction or pace of international liberalisation. This certainly remains the case in 2023. Iatrou and Oretti (2007) state that airlines “wishing to become a global player” and expand their global reach look to alliances to do so without committing “sizeable capital investment” (p. 3).

4. Discussion

4.1. *Swissair – when the hunter becomes the hunted*

Swissair’s hunter strategy, in large part developed by the carrier’s management consultants at the time (US-based McKinsey and Company), saw the airline invest billions of dollars in a range of essentially debt-laden second-tier European airlines including Belgium’s Sabena. It should be noted that McKinsey has always maintained that it had no involvement in the implementation of the strategy, and so cannot be held responsible for its ultimate failure. Whatever view one takes of McKinsey’s role, the main point is that Swissair made a series of poor equity investments that resulted it being unable to extricate itself from the mire of its partners’ financial woes (Chang & Williams, 2002).

Although many key factors have been highlighted to help explain the collapse of Swissair in October 2001; from the fatal crash of one of its MD-11’s off the east coast of Canada in 1998, to the 9/11 terrorist attacks the month before its demise in late 2001, to Switzerland remaining outside the European Union (EU) and Eurozone – poor strategic decision-making exemplified by the hunter strategy is widely considered the most to blame (Hermann & Rammal, 2010). A very important difference between Etihad and Swissair (of which there are many) is that of leadership quality, including knowledge and experience of the global airline industry. Etihad has leadership with clear expertise in the industry, while Swissair was led by a CEO and board comprising only politicians and bankers at the time of its collapse. Etihad is not in any danger of collapsing. Etihad’s former CEO James Hogan, a long-time industry insider, was always keen to point out that his airline was not attempting to emulate Swissair, in particular arguing at one point that he was not interested in taking “management control” of partner airlines (Kingsley-Jones, 2013b, para. 23).

Although Swissair’s leadership deficit was substantial, equity investments in debt-burdened smaller airlines still drain precious resources and occupy human capital in less than efficient and effective ways. US billionaire investor Warren Buffet, admittedly no fan of the airline industry, maintains that: “When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact” (Phillips, 2013, para. 9). Encouraging deeper partnerships, and building stronger exit barriers, can result in outcomes that are not always positive. Smaller players can become over reliant on their benefactor, with the major backer running the risk of its fortunes being potentially irreversibly wedded to those of its minor partner/s. Swissair accepted nearly complete financial responsibility for most of its partners (Knorr & Arndt, 2004).

Swissair attempted on many occasions to develop a global alliance – the KSSU alliance, the European Quality Alliance (EQA), Atlantic Excellence and Global Excellence, and then the aborted Alacazar project – most of which failed as members progressively headed elsewhere, mainly into the newly formed global alliances of today (Knorr & Arndt, 2004). Finally, with the Qualiflyer alliance Swissair decided to move away from the previous lower levels of

investment that were aimed at providing a strong yet mostly symbolic message of cooperation and collaboration, as they had all faltered due to significant member defections (Suen, 2002). With Qualiflyer, Swissair was determined to build a stronger group, albeit with mostly smaller industry players. Swissair decided larger investments were needed in order to give it the dominant position to better control the alliance's development and ensure member loyalty (Baliga, Santalainen, & Lottenbach, 2008).

4.2. *Etihad: trailblazer or pragmatist?*

Etihad is trying to forge a strategic direction that best fits its circumstances. Not far away in Dubai is its much bigger and more powerful national counterpart Emirates Airline. Not much further away is its other main regional rival Qatar Airways. These three Gulf carriers have to date forged quite different paths when it comes to international partnerships (Aquilina Spagnol, Ellis & Pagliari, 2020). Emirates has opted to exploit its size and power to build a series of global strategic partnerships, the most high profile of which is with Australian flag carrier Qantas Airways. Emirates remains steadfastly opposed to the major global alliances, viewing such membership as out dated and unnecessarily restrictive. As for equity stakes, Emirates CEO Tim Clark remains in no hurry to repeat the experience of a 40% minority investment in Air Lanka begun in 1998. "Clark has justified his decision to stay away from airline investments as buying equities in other airlines takes away management attention on Emirates" (Jayaweera, 2018, para. 3).

Meanwhile, Qatar has formerly joined the oneworld global alliance – interestingly, Qantas is also a oneworld member. Qatar views the global alliances as here to stay and very much a part of the industry's future. Emirates is evidently big enough to be wrong about the future of the global alliances; that is, it can afford to forge a strategic path with or without them. Qatar probably cannot, while Etihad may yet decide that it will join one of the big three. At present, not unlike a decade ago, Etihad is content to view "itself as a "crossroad", playing across all the global alliances" (Kingsley-Jones, 2013b, para. 30). As a past EU commissioner for competition noted about Swissair before its demise: "Swissair is too small to become big and too big to remain small. Swissair should aim for a larger alliance than their current partnership" (Baliga et al., 2008, p. 195). Etihad's current strategic context is not dissimilar, especially in the context of post Covid-19 pandemic.

Although Etihad's position on global alliance membership is somewhat ambiguous, oscillating between scepticism and openness, its equity investments and code-sharing deals reflect a level of pragmatism that may see it pulled into a more established strategic direction in the future. Etihad for a time did manage a growing array of equity partners, including non-aligned Virgin Australia and oneworld alliance member Air Berlin, while it also has a deepening strategic partnership with SkyTeam's Air France/KLM and codeshares with ITA Airways (amongst others). While this pragmatic partnering is nothing new in the industry, it does suggest that Etihad may not have fully settled on whether to go the direction that Emirates is going, or to take Qatar's lead and join a global alliance. Code-sharing provides an effective mechanism for handling risk by allowing capacity to be rapidly reduced if demand decreases (Adler & Gellman, 2012). Equity partnerships are less flexible (Vasigh et al., 2013).

Although passenger numbers and revenues did for a time improve across Etihad's key partners, this did not last. The option for Etihad of forging its own path may seem to challenge the legacy carrier status quo; however, such a course of action did ultimately see it left with some peripheral and very reliant partners. Before the partnerships began unravelling, it was noted that even if success proves challenging, the financial and political backing of Abu Dhabi meant failure was unlikely (Kingsley-Jones, 2013a). Too well backed to fail does leave room for a certain degree of business experimentation, but ending partnerships as challenges mounted has also proved costly for Etihad.

Air Serbia had been touted for its location in the Balkans, providing it is argued, access to the growth potential of southern Europe, as well as a launching pad into the rest of Europe. Its geographic location at the southern edge of Europe actually proved a bigger obstacle to overcome than any latent growth potential. Likewise, Air Berlin and Jet Airway delivered the Etihad equity-based alliance more challenges than opportunities. Certainly, both the German and Indian markets were ripe for growth. Etihad could likely have achieved this same growth through code-sharing, while freeing up capital to use its own aircraft when possible, or to buy or swap airport slots if required. Swissair demonstrated that greater dependence on the part of smaller alliance partners can lead to the senior partner struggling as well, rather than it leveraging its power and expertise to build a strong global network of international partners.

Equity investments also seriously constrained Swissair's ability to either attract new partners or expel redundant ones (Gudmundsson & Lechner, 2006).

4.3. *The pursuit of profitability: when the stakes are too high*

It is no secret that the global airline industry has historically struggled to make a profit, albeit with post-pandemic demand and revenues currently bucking this longer-term trend. Warren Buffet's colourful warnings against investing in the airline sector could equally be applied as a cautionary note for airlines investing in other airlines. Research into the effect of alliance membership on individual airline efficiency (e.g. economies of scale, etc.), has shown a measurable improvement, but profitability increases have for the most part remained elusive (Oum, Park, Kim, & Yu, 2004). Alliances may very well limit potential losses; however, they do not spark the profitability the industry has long sought. Equity stakes in airlines that would otherwise have little chance of stemming their losses, let alone making a profit, might just reflect the old adage 'throwing good money after bad'.

During his time as Etihad CEO, James Hogan highlighted 'scale', including the purchasing power that the overall group of equity partners enjoys. He argued in 2013: "We're achieving considerable group deals, which is the important flip-side of this equity strategy: to build scale and improve unit cost" (Kingsley-Jones, 2013b, para. 24). Hogan added that: "This isn't the old Swissair model of acquiring brands. This is about how to we use this scale to improve the bottom line" (Kingsley-Jones, 2013a). Scale through equity investments can create linkages that are much more challenging to break if losses and debts are not reversed in time. Swissair was equally not interested in other airline brands. What Swissair really wanted was to build a global alliance like no other. Unfortunately, it chose heavily reliant partners with more contemporary problems than future potential, to do so. Interestingly, Etihad Regional (through the rebranded Darwin Airline) attempted to take advantage of Switzerland's geographically central position in Europe (CAPA, 2013); a situation not fully available to Swissair as Switzerland was not then, as now, fully part of the European single air market (Doganis, 2010). Swissair also failed "to [fully] integrate its regional subsidiary Crossair" (Knorr & Arndt, 2004, p. 119).

4.4. *Why not join a global alliance?*

One major opportunity that many analysts agree was passed over by Swissair was to join one of the big three global airline alliances – Star, SkyTeam or oneworld. In the late 1980s Swissair led the industry by being the first significant European airline to partner with a US major, Delta Air Lines. In 1989 Swissair joined with Delta and Singapore Airlines to create Global Excellence which is widely regarded as "the first truly global alliance" (Iatrou & Oretti, 2007, p. 25). Delta later chose Air France and started SkyTeam, Northwest Airlines chose Dutch flag carrier KLM; before too long Air France/KLM merged (though keeping their individual brands), while Northwest later merged fully into Delta. These carriers continue in SkyTeam today. Swissair belatedly sounded out the major global alliances in 2001 but to no avail (Baliga et al., 2008). Even though it eventually disbanded, according to Iatrou and Oretti (2007): "Global Excellence remained the epoch-making forerunner to all other global alliances" (p. 26). Evidently, Swissair elected to pursue control of an alliance of its own making, rather than the more risk adverse strategy of allying itself with well-known and established industry players (Hermann & Rammal, 2010).

Swissair's management team felt that forging a path towards membership of the top cluster of carriers in Europe meant buying an alliance from the outset, not simply providing feeder traffic to one of the three burgeoning global alliances. Etihad seemed to be equally focused on going its own way, under the 'hybrid' mantle. Swissair's management "was keen on shaping the future and emerging as a dominant player" (Baliga et al., 2008, p. 188). Swissair achieved the former to an extent that is still arguably being felt today; while the latter was never achieved, instead Swissair has joined the ranks of the industry's many historical relics. The *Centre for Aviation* appeared confident in 2013 that "Etihad's move is almost certainly the logical way forward for the industry to evolve"; before adding: "But there are still sceptics about the theory of evolution in aviation" (CAPA, 2013, para. 42). History suggests that this scepticism is not altogether unwarranted, with Etihad's current context, and James Hogan's retirement, evidence that the sceptics have mostly been correct. Even so, Qatar Airways continues to pursue minority equity stakes in other airlines, though IAG (25%) and Cathay Pacific (10%) would not be considered second tier (Horton, 2020).

5. Conclusion

5.1. Future scenarios for Etihad

There are a number of possible future scenarios and strategic options that Etihad, and indeed airlines considering pursuing equity stakes, could contemplate; including:

- Continue investing in airlines as and when opportunities arise, all the while being willing to face the potential gains and losses as they materialise (with a view that combined strength will hopefully outweigh any individual member challenges).
- Join a major global alliance. In Etihad's case, either SkyTeam or Star Alliance would seem to provide the best fit (again, neighbouring key regional competitor Qatar Airways is a oneworld member, while Saudia in the Kingdom of Saudi Arabia (KSA) is part of SkyTeam, though more a potential partner for Etihad than a strong competitor).
- Help create a fourth global alliance to compete with Star, SkyTeam and oneworld. Etihad could possibly even convince national counterpart, and alliance opponent, Emirates to join and play a leading role; the lack of a North American (particularly US) member would be a problem though. Swissair found this to be the case with both European Quality Alliance and Qualiflyer in the 1990s (Gudmundsson & Lechner, 2006).
- Merge with national competitor Emirates Airlines to create a United Arab Emirates (UAE) mega carrier, remaining unaligned, but nevertheless, a global powerhouse.

5.2. Final thoughts

Etihad Airways would seem a good fit for SkyTeam membership. The airline already codeshares with SkyTeam members Air France/KLM and ITA Airways. However, predicting the future is no easy feat, as is applying historical lessons to current circumstances. Even so, the general rule that things get more complicated and challenging to manage and control the more players and resources are involved, at least provides a cautionary note worth considering here. Added to this, the revenue benefits from any airline-to-airline business relationship whether interline, code share, strategic bilateral partnership or equity stake, are challenging to accurately forecast as the realised economic benefits do not always mirror expectations. However, being anchored to the economic fortunes of other airlines often brings greater risk than likely benefits. Less intertwined airline business relationships succeed based more on mutual economic benefits achieved over time, than on financial depth of the connection; a somewhat counterintuitive notion that further complicates the historical lessons available from a hindsight analysis. Swissair's difficulties in keeping partners should not then have formed the basis to make a business case to buy partners. Likewise, Etihad's understandable search for airline partners need not result in following this example again.

The greatest lessons from Swissair are for carriers that find themselves caught somewhere in between the big industry players and the smaller ones. In this context, two core lessons dominate; firstly, do not underestimate the value of global alliance membership; and secondly, avoid the financial risks associated with equity stakes in second-tier airlines. Whatever strategic path Etihad Airways navigates into the future, one thing appears worthy of consideration; it should not have closely replicated the Swissair equity-based alliance model in the 2010s, nor indeed ever again.

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