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Crisis and Strategic Alliance in Aviation Industry

A case study of Singapore Airlines and Air India

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Abstract

Early sights of recovery from the US cultivate hope for the miraculous resurrections of many industries. The consumers in developed markets, who are still daunted by the shaking complications of the crisis however, will be expected to respond to the positive news in a more cautious manner by which their consuming habits remain relatively conservative with limited allocation of budget for luxurious demands such as travelling. Such a harsh reality poses the probable challenge for the airlines industry in its constant quest for continued growth. The article recommends a possible solution for the dire situation by encouraging an alliance between airlines with a strategic fit. The process of identifying appropriate partners will be illustrated through a case study of Singapore Airlines and Air India in which relevant factors will be addressed to explain why a strategic alliance can help both airlines triumph over the crisis fruitfully.

The global crisis harshly hit the aviation industry as demands for air carriage drop due to the tightened budgets of consumers. The situation is even more severe for Singapore Airlines (SIA) given its peculiar local context. One possible remedy for this struggling situation is to acquire stake in Air India to tap on its fast-growing domestic market with huge potential for further expansion in the near future.

Many factors seem to support the marriage of the two airlines including the general environment and Indian aviation industry trend.

General Environment Consideration

Economic climate poses an obscure landscape as credit crunch starts to spread worldwide. With many foreign investments to be withdrawn, funds become less available and more costly for firms, even the ones with good opportunities for growth, to obtain. Therefore, any equity alliance in the form of capital injection would be greatly welcomed by Air India.

Cultural trends exhibit an inclination toward multiculturalism by which service crew are intensively trained to better address the needs of different group of customers. Henceforth, the success of SIA in building a customer-centric culture as a core value of the organization will sweeten the investment deal.

Demographic trends demonstrate a consistent increase in the world population, which largely comes from those highly reproductive countries such as China and India. It opens up the tremendous opportunities for firms like SIA to venture into these untapped markets

Technological changes allow the air carriers to flexibly, and still economically, accommodate demands by choosing air-crafts with different capacities. Together with the increasing availability of the Internet, air travelling services also become more popular to the consumers. With headquarter rooted in one of the strategic hubs for science and technology in Asia, SIA can facilitate a convenient channel for Air India to access the latest innovations in the aviation industry.

Political conditions are further mitigated with more liberal policies in place to encourage FDI. Evidently, greater foreign ownerships in multiple industries are approved by local governments all over the world (e.g 20 - 25% in Indian Airline industry).

International events were highlighted with the 11/9 incident whereby immigration regulations and security standards have been tightened by Western authorities in particular, and subsequently lead to higher barriers for tourists flow to those destinations. On the contrary, Asian countries remain relatively less stringent in their Visa issuance to promote tourism industry and thereby possibly attract more global visitors. Henceforth, an investment in tourism related businesses in

Asia, such as airlines, might prove to be highly profitable decision.

Indian Aviation Industry Trend

Starting in 1992, the Indian government adopted the Open-skies policy to entice foreign players to its aviation industry. Since then, many participants have joined the market due to *lower entry barriers*. During the mid-90s, a market shake-up however, swept away a handful of incompetent players and left only the fittest to survive. Given the increasing competition, SIA investment decision is believed to be favored by Air India due to the world-class experiences of SIA in effectively operating the airline and hence enhancing its partner's competitive advantage

Furthermore, the *threat of rivalry* is keen in the Indian aviation industry whereby service standards of all airlines go up meanwhile the fare price must be reduced. Not only that, but the introduction of budget airlines heightens the competition, which recently motivated Air India to open its Express subsidiary to cater to this particular market segment. This factor will make SIA's offer more attractive because its prior expertise with Tiger Airways, one of the leading budget airlines in Asia, will benefit Air India.

In spite of the fierce intra-industry competition, Indian domestic air carriers enjoy a *low threat of substitutes* as alternative transportation means are unable to provide such level of convenience at the sufficiently attractive prices. Provided the huge population of the country, an ownership of Air India will allow SIA to leverage on its large customer base to grow business.

However, domestic airlines still experience *t*remendous *pressure from buyers.* Given the great number of airlines as well as the competitive pricing, customers can easily switch to those airlines which can provide better matches to their preferences. With years of experience in yield management -- a revenue optimization technique in airline industry -- SIA will be able to help Air India in practicing dynamic pricing so as to appeal to more customers as well as increase profits.

The last factor that SIA should consider before acquiring stake in Air India is *the threat of sellers*, namely airport and fuel service providers in India. As Air India is a national airline and all airports are state-owned, the associated risk will hence be perceived to be very minimal, if not none. Fuel prices, however, is expected to be more volatile and therefore poses greater risk.

An marriage of convenience or A strategic move?

In short-term, it appears that Air India can immediately benefit from the extensive experiences of SIA and its cash-rich resource especially in light of the current economy with only few sights of recovery. Service standards will probably be improved providing that SIA shares its personnel training and technological support (e.g. in-flight entertainment system). Most importantly, a capital injection will allow Air India to develop its fleet to keep up with the increasing domestic demand over a long-term horizon.

On the other hand, an equity investment in Air India implies a sound decision for SIA financially and strategically.

Financially, the deal can be justified by calculating its present value. Currently, Air India is ranked second in terms of its share of 15.4% of domestic aviation market which was estimated at $5.6 billion in 2008 with annual compounding growth rate of 18%. As such, a 25% equity investment will have a present value of about $2.156 billion assuming profit ratio of 20% and perpetual growth rate of 18%.

Strategically, SIA, in long-run, is able to gain a foothold in Indian market to “position the airline for continued growth in a globalizing industry while maintaining the airline’s loss-free record” (SIA – Global Challenges case – Stanford Business School).

Ultimately, the alliance is expected to enhance the competitive advantages of both parties by mutually leveraging each other’s resources as well as tapping into a larger customer base for growth. Therefore, their marriage, although originally might be induced much by reasons of convenience, the strategic implications are vividly long-term driven.