Carriers of globalization; airline development between globalization and de-globalization, the case of Royal Dutch Airlines, 1980-2010

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Introduction

Aviation went through an impressive development in the 20th century: ever larger, faster and safer aircraft opened the way to exotic destinations for more and more people. Since the late 1980s air traffic has grown enormously. Civil airlines saw passenger numbers triple to over 4 billion in 2015 and cargo volumes doubled over this period. In 2015 the global fleet consisted of 22,000 aircraft serving some 1700 airports (IATA/WATS).

Airlines benefited from the growing demand for air transport caused by an increased globalization and, in turn, contributed to this process of global interconnectedness. International trade, investment and finance, migration and tourism were highly facilitated by the airline industry (Held, McGrew 1999; Doganis 2006, IATA 2015). Globalization offered the airlines many opportunities that were particularly stimulated by the gradual deregulation of aviation after 1978. Strict bi-lateral agreements gave way to new legal instruments that were in line with the liberal philosophy that prevailed in this period and turned out to be important in the process of globalization.

However, deregulation and globalization was not only a blessing for the airlines, there were also many threats and restrictions. The increasing demand for air transport caused infrastructural problems for many airport authorities, which hampered the opportunities for growth of different flag carriers. But also the volatility of fuel costs, growing levels of consumer dissatisfaction and above all an increasing global competition could curtail the development of an airline (Gourdin 2016). Few realize that, despite the glamour of the industry and the unmistakable role as drivers of global interconnectedness, most airlines entered into serious problems when the extensity, intensity and velocity of global networks increased. Only few companies succeeded in achieving long-term profitability and many carriers even ceased to exist. In order to survive, airlines had to adapt to new strategies that fitted the changing economic and institutional settings. The finding of an appropriate answer to the challenges and constraints of globalization (and de-globalization) became indispensable to develop a viable industry.
This paper deals with the impact of deregulation and globalization on the airline industry during the last decades of the 20th century and the beginning of the new millennium. It will introduce the case of Royal Dutch Airlines (KLM), founded in 1919 and still one of the largest airlines in Europe. How did the flag carrier of the Netherlands develop within the liberalized world (beyond borders) and how did the company cope with the risks and uncertainties of new markets and unknown competitors that entered the market? This paper will look at the instruments of coordination to structure and restructure the industry. It will highlight the consolidation process that culminated in the merger of KLM and Air France in 2004.

To a liberalized world

In the pre-globalized world of the 20th century aviation was subject to a limited set of strict rules. Airlines' room for maneuver was determined by a legal framework that was at its core established during the first months after the end of the First World War. The Paris Convention of 13 October 1919 stated that the air above a country was not 'free'. This was a consequence of the war, which for the first time witnessed bombed targets from the air. The Paris agreements Paris did not make international connections through the air impossible, but in order to fly to another country airlines had to rely on bilateral agreements between the States party to the convention. This made airlines highly dependent on the cooperation with their national governments who had to negotiate. Airlines and landing rights became an instrument of international politics (Dierikx 1988).

In 1944, the United States initiated an international meeting in Chicago to create a new legal framework for civil aviation. They wanted to strengthen their political and economic dominance in the world and therefore sought a system with few restrictions on access to international markets, and open competition between airlines. The Netherlands supported this aim. But a large group of countries, with Great Britain at the forefront, advocated a more restrictive policy for safety reasons, and, to protect their national airlines. Bilateral agreements in which the exchange of landing rights was at the core remained the rule in international air traffic. At the end of the 1970s, world's aviation counted approximately 4 000 of these bilateral agreements.(Wassenberg 1970; Dierikx 1986; Doganis 2006; Odoni 2015). In order to be able to operate international scheduled services, an airline had to have a license from the land to be flown. In addition, as many as five so-called 'freedoms' were created in Chicago, whereby rights
were exchanged to fly over a state without landing, to make a technical stopover if necessary, to transport passengers, cargo and mail from the other country and also from third countries on the route of the scheduled aircraft. In later years, new ‘freedoms’ were added to the Chicago agreements. (Doganis 2006; Odoni 2015; Gourdion 2016).

The strict regulation of aviation with its national embedding did not mean that the airlines had no possibilities of transnational cooperation or that there wasn’t any competition. On the contrary, KLM cooperated with competitors since its inception. Until well into the 1980s, that cooperation consisted mainly of technical-operational support, aircraft rental and leasing, and sometimes financial support for the purchase of aircraft. From the 1950s, when mass tourism emerged, *flag carriers* were confronted with new entrants on the market. These charter airlines accounted for an increasing share of passenger transport with relatively cheap tickets. These non-time-scheduled airlines fell outside the bilateral regime and therefore turned out to be formidable competitors. Because they leased entire airplanes to travel organizations, which often sold the tickets in combination with hotel facilities, charter companies had fewer problems with the occupancy rate of the plane. In order to make optimal use of their valuable assets, KLM, like most other airlines, hired out its airplanes to these travel organizations. In this way, the ‘old’ airlines more or less became competitors to themselves. In the meantime, there was no question of a level playing field for scheduled and charter services. Despite the continuous rate reductions, the introduction of the tourist class in 1952 and the introduction of the economy class agreed by the members of IATA in 1958, the charter companies continued to enjoy an advantage (Camilleri 2018).

In the 1970s, when the aviation sector was in dire straits as a result of rising oil prices, new initiatives were taken to develop further cooperation. For example, KLM, Luxair in Luxembourg and Sabena in Belgium tried to form an alliance. Although the national governments were initially positive about this joining of forces within the Benelux, the attempt was unsuccessful. It turned out that it was not easy to reach agreement on control between these companies, which were very different in size. The fact that Sabena was a structurally loss-making company did not do any good to the matter. It was only in the 1980s that long-term alliances between airlines of different nationalities came into being.

The oil crisis, which hit the airline business hard, made it clear that the existing regulations needed a revision. In the first half of the 1970s, the industry recorded large losses and
companies were forced to increase most fares. Under these circumstances, the United States took the lead to put an end to the restrictive nature of aviation regulation. Regulation which focused mainly on market access, prices and capacity had to make way for competition. President Jimmy Carter launched the *Airline Deregulation Act* in 1978, which allowed American airlines - initially against their will - to decide for themselves which routes to fly and at what price to do so. This new legislation illustrated the changing ideology on markets and regulation that emerged in the United States, but conquered the world in the years that followed (Hall and Soskice 2001). The Dutch government and KLM in particular were positive. The 'freeing up' of the air offered a small country with a relatively large airline more opportunities for growth (Pitt and Norworthy 1999; Doganis 2006).

**The new order and first cooperation**

In March 1978, the Netherlands was the first country in Europe to conclude an open market agreement with the United States that replaced the complex bilateral agreement. Both countries endorsed the intention to achieve greater freedom and to limit the role of the state with regard to frequency, capacity and prices. The airlines now set their own fares and flight frequencies. This was a very advantageous deal for KLM. In the mid-1980s, KLM handled approximately eighty percent of transatlantic air traffic to and from Amsterdam. By efficiently organizing its connections, KLM also served an important part of the European market. Many passengers travelled through the Amsterdam Airport Schiphol hub to one of the many intercontinental destinations KLM offered.


The US-Dutch agreement set a trend that was soon followed by other European countries. Germany and Belgium feared a loss of market share and soon concluded a similar agreement (Doganis 2006).

Deregulation in the US waked up European authorities. The many bilateral agreements and pooling contracts between the various national airlines were clearly in need of revision. At
the end of the 1970s, initiatives were developed at a European level which, following the American example, had the intention to give room to competition and lower prices for consumers. The Netherlands and Great Britain took the lead. In 1984 they were the first in Europe to conclude a deregulation agreement in which air traffic between the two countries became completely free. This freedom soon produced the desired result. Between 1985 and 1990 the number of passengers between the two countries increased by more than fifty percent. Partly because of this, KLM recorded significantly higher profits in this period (see graph 1) (Annual reports KLM 1970-2017). However, it goes at this point too far to claim that deregulation led to better results for KLM. As we will see below, deregulation did not necessarily result in higher profits. Particularly after the turn of the century, there was an enormous volatility in operating results.

The successful cooperation of the Dutch and British governments regarding air traffic encouraged the more protectionist European countries and their flag carriers to revise their way of cooperation. In the meantime national governments had much less say in the way air traffic was organized during this period. As said, the center of gravity slowly but surely shifted from the national government to the European Community (Dienel and Lyth 1998; archives KLM, annual reports 1980-1990; Bouwens and Dierikx 1997). In 1986, Europe decided on a phased liberalization, which was to be completed by the end of 1992, the crucial year of European
integration. Several packages of liberalization measures followed, aimed at introducing differentiated tariffs on European scheduled services and increasing access to each other's markets. The bilateral fifty-fifty distribution of market share on each route was no longer the starting point. From 1991, a company was allowed to capture 75 percent of the market share. Two years later, the European authorities even agreed that within the common market, both international routes and domestic services would be opened up to all companies licensed by one of the Member States (Dierikx 1999).

This blurring of national borders had far-reaching consequences for the airlines and the concept of national flag carriers. As in several countries in North-West Europe, the national airline KLM became less and less an extension of the Dutch state. The idea that airlines were not essentially different from other industries gained ground in politics (Doganis 2006). This was reinforced by the rapid phasing out of subsidies and other support measures to the industry, a policy that was accompanied by privatization. Public authorities decreased its direct influence in services, energy and public transport (Peet en Nijhoff 2015; Sluyterman 2015) and also in the national airline. Since 1983, the Dutch government gradually divested its interest in KLM. In 1986, after almost 60 years, the majority of the shares was no longer a fact (see table 1).

Table 1: privatization KLM, 1983-2004

<table>
<thead>
<tr>
<th>Date</th>
<th>Common shares KLM</th>
<th>% state</th>
<th>Pref. shares by state x 1000</th>
<th>Priority shares by state</th>
<th>% voting right state</th>
</tr>
</thead>
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<tr>
<td>Aug. 1983</td>
<td>39.598.660</td>
<td>75</td>
<td>20.000</td>
<td>1300</td>
<td>75</td>
</tr>
<tr>
<td>Dec. 1983</td>
<td>39.598.660</td>
<td>69</td>
<td>20.000</td>
<td>1300</td>
<td>69</td>
</tr>
<tr>
<td>April 1986</td>
<td>49.434.700</td>
<td>55</td>
<td>10.000</td>
<td>1300</td>
<td>55</td>
</tr>
<tr>
<td>March 1987</td>
<td>61.964.180</td>
<td>39</td>
<td>10.000</td>
<td>1300</td>
<td>39</td>
</tr>
<tr>
<td>March 1994</td>
<td>63.935.192</td>
<td>38</td>
<td>10.000</td>
<td>1300</td>
<td>38</td>
</tr>
<tr>
<td>March 1996</td>
<td>86.118.750</td>
<td>30</td>
<td>11.750</td>
<td>1300</td>
<td>38</td>
</tr>
<tr>
<td>June 1997</td>
<td>68.828.420</td>
<td>12</td>
<td>11.750</td>
<td>1300</td>
<td>25</td>
</tr>
<tr>
<td>March 1999</td>
<td>61.485.028</td>
<td>0</td>
<td>11.750</td>
<td>1300</td>
<td>14</td>
</tr>
<tr>
<td>March 2002</td>
<td>46.808.699</td>
<td>0</td>
<td>8.813</td>
<td>975</td>
<td>14</td>
</tr>
<tr>
<td>April 2005</td>
<td>46.809.699</td>
<td>0</td>
<td>3.709</td>
<td>975</td>
<td>5,9</td>
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</table>
The Netherlands were not an exception. Many governments in Europe decreased their share in
the national airline. Under Margaret Thatcher, the British were the first. British Airways was
already completely privatized in 1987. In Germany the government sold its last shares in
Lufthansa in 1997. Not all countries were equally energetic in handling over their flag carrier to
market forces. In France and Italy, the governments hesitated to privatize and Air France and
Alitalia remained largely state owned for a long time to come (Dienel and Lyth 1998; Shibato
1994; ICAO 2008). In reality the Dutch government kept a legal back door open to be able to
increase the interest to 50,1 percent again if this should prove necessary for aviation policy
reasons (HSG 1996).

During the second half of the 1980s European airlines reconsidered their position and
tried to cooperate. That turned out not to be easy. KLM, for example, tried to form an alliance
with Austrian Airlines, Scandinavian Airlines System and Swissair. This project, which was
given the significant name Alcazar, came to nothing. For the time being, national identities and
cultural differences stood in the way of closer cooperation. Financial problems and existing
alliances of the various partners also made this project doomed to failure (Bouwens and Dierikx
1997). Other attempts at far-reaching cooperation did not get off the ground either. For a long
time, KLM worked on an alliance with the structurally loss-making Belgian airline Sabena,
which might develop into a major competitor of KLM and Amsterdam Airport Schiphol as a
result of the plans to expand Zaventem airport. Apart from this defensive consideration and the
possible cost savings of a cooperation with the Belgians, KLM did not consider an alliance with
Sabena to be obvious. Two hubs barely 150 kilometres apart did not generate enough synergy
(KLM, minutes supervisory board 19-1-1990).

Meanwhile, increased ‘freedom of the air’ and the recovering economy caused a growth
in passenger numbers at European airports. In the mid-1980s, KLM carried more than five
million passengers, which had doubled ten years later (Annual reports KLM 1985-1995). KLM’s
home base, Amsterdam Airport Schiphol, was in danger of congestion. A system whereby
airlines were granted specific location and time-related landing rights - the so-called slots -
provided some relief, stipulating that the airline with the oldest rights was also entitled to the best
gates at the airport in question. This reinforced the mutual dependence of KLM and its home base
Schiphol. In this system, the connection of regional airports to the existing main network also
became more important. In order to make optimal use of this system, KLM switched to a block
schedule in 1992, in which the aircraft entered and departed in three daily waves. The liberalization of the air transport sector gave additional weight to such adjustments that were necessary to manage and control the growth of air traffic. (Bouwens and Dierikx, Annual reports KLM, 1989-1992).

KLM was a pioneer in Europe, not only in its early cooperation with the British. Of crucial importance in the development of the Dutch airline was the alliance that it formed as early as 1989 with the number four of the United States, Northwest Airlines (NWA). Such a strategic link was more likely to succeed than European cooperation agreements, which were often hampered by disagreements over the division of the common market. The cooperation with NWA would significantly expand the network that KLM could offer its customers, while achieving significant cost savings. The cooperation went far beyond previous agreements on aircraft maintenance or coordination of reservation systems (De Man 2006). The fact that NWA did not have a very solid cash position and owned a very outdated fleet did hamper the cooperation. NWA went into partnership with a group of investors who also involved KLM in the deal by giving the Dutch airline the opportunity to participate in their holding company. Instead of a joint venture, KLM now became involved in the operation of the American partner and invested almost 600 million guilders in this deal.(KLM, minutes supervisory board 19-5-1989).

The cooperation between KLM and NWA was a first in the aviation world. KLM flights connecting to NWA flights now also received a NWA flight number in addition to a KLM flight number. This code sharing was made possible by developments of the computer reservation systems for booking tickets. KLM passengers could now travel with one ticket from Schiphol to all airports in the United States. NWA passengers in turn could use KLM's European connections. The fact that it was not always clear to potential customers which airline was operating the flight was no longer seen as a problem by the airlines themselves. The aircraft of both airlines had the same 'Worldwide Reliability' logo and the airlines coordinated the sale of tickets, marketing and inflight services. When the Netherlands concluded a new agreement with the US in 1992, in which they further expanded and specified their freedoms - an open skies agreement - KLM was the first foreign airline to fly to all destinations in the United States (Oum, Park, Zhang 2000; Doganis 2006; KLM, annual reports 1992-1993).

In the years that followed, deregulation gained momentum, a momentum that once again accelerated competition. In 1997, the complete deregulation of European aviation was agreed
upon. Air carriers were not only able to set prices and frequencies, but were also able - the so-called seventh freedom - to operate domestic flights in another country. It was not until November 2002 that this was achieved. The European Court of Justice ruled that the bilateral agreements were no longer in force. A KLM aircraft could therefore now, in principle, also operate a service from another European airport and, for example, operate flights between Paris and Lyon or between London and Frankfurt (European Court of Justice, IP/02/1609, 5-11-2002). Liberalization of air traffic grew as more open skies agreements were concluded. The agreement the Netherlands had with the United States served as an example. Airlines from countries involved in such an agreement were given unlimited access to each other's markets and more freedom in terms of fares, frequency and capacity. Crucial in international aviation was the open skies agreement the United States and the European Union concluded in March 2008. It stipulated that European and American airlines could fly to all airports in Europe and the United States. The new policy had far-reaching consequences for competitive relations in the airline industry (Cento 2009; Middeldorp and Ooik 2003).

Global alliances

At the end of the twentieth century, aviation was characterized by a desire for closer cooperation. To eliminate risks and uncertainties and to increase their market share, almost all airlines sought and found partners. In the second half of the 1990s the number of alliances, from code sharing to joint ventures, had risen to more than five hundred (Lindquist 1999). This was the result of major uncertainties in the market, but also by the economic headwinds that arose in these years. The urge to coordinate business and cooperate became more important after 2001. The crisis following the terrorist attacks of 11 September 2001 on the World Trade Center in New York and the Pentagon in Washington also hit aviation hard. In the first year and a half after the attacks, the sector made losses of more than USD 30 billion, the number of passengers on the North-Atlantic route fell by almost 20 percent and one airline after another went bankrupt (Button 2002; KLM, minutes supervisory board 6-5-2003). For KLM, the 2002-2003 financial year, with a loss of almost 500 million euros, went down in history as the worst year ever (see graph 1).

The airline alliances were all aimed at increasing the revenues of the participating companies, but had many manifestations. Each airline built over the years a web of agreements
relating to operational activities or serving specific markets. New was the creation of global alliances, when airlines from different geographical regions worked together to achieve global coverage of their networks. This allowed new markets to be explored and costs to be saved through code sharing (Pels 2000; Cento 2009). Although the geographical scope of the cooperation was relatively limited, KLM's cooperation with NWA was for a long time a shining example of a global alliance. In the 1990s KLM also invested in airlines such as Kenya Airways and Braathens in Norway. Around the turn of the century, a financial participation was seen as a condition for the commercial development of a cooperation. Although this point of view slowly but surely disappeared, KLM remained active and, for example, again took part in Kenya Airways in 2012. This enabled the Dutch airline to open up a large part of the African market via Nairobi (De Volkskrant 31-3-2012).

With its subsidiary KLM-UK, its agreements with and participations in European airlines such as Braathens of Norway, the French regional airlines and German Eurowings, KLM had a strong European network. In addition, the cooperation with NWA contributed to a good connection on the North Atlantic route. Nevertheless, at the beginning of the new millennium, KLM was surpassed by its major European competitors who succeeded to create global networks. Because new partners of KLM may have failed for various reasons, KLM came into a kind of isolation in which it could only rely on the cooperation with NWA (KLM, annual report 1999-2000).

In 1997 Star Alliance was created with Lufthansa, Air Canada, Thai International, the American United Airlines and the Brazilian Varig as partners. Star Alliance was a great success and in 2004 the alliance already counted 17 members. One year after the establishment of this partnership, British Airways entered into the Oneworld alliance with Canadian Airline and others. Finally, in 1999, the third major alliance in aviation - Skyteam - followed around the cooperation of Air France and Delta with Aeromexico and Korean Airlines, among others. Although these global alliances were not always stable and airlines - whether or not through mergers or acquisitions - changed parties regularly, most companies were convinced of the benefits. KLM also had to consider joining one of the major alliances (KLM, minutes supervisory board, 12 and 13-9-2001).

Considering the limited scope of its own alliance with NWA, KLM envisaged a partnership with one of the three major alliances, Oneworld, Star Alliance or Skyteam. KLM,
together with Sabena, which went bankrupt in 2001, and Swissair, which also had severe financial difficulties, was the only European airline that did not belong to one of the global alliances (Meyer 2017). KLM executives struggled with the question to what extent the Dutch airline could present itself as an independent company within such an alliance. In the KLM’s view, joining an alliance was not enough to win the competition in the long term. This required further cooperation and integration with other airlines. Could KLM play an active and leading role in the consolidation process?

It was clear that KLM could not take on the role of ‘consolidator’, but doing nothing was not an option either. There were no serious partners within the national borders and cross-border mergers and acquisitions were still an unknown phenomenon in the airline industry at that time. National interests and the role many governments played in the operations and management of their flag carriers made a cross border merger even more difficult. KLM experienced this at first hand in its cooperation with the Italian airline Alitalia. In November 1998, an agreement was signed that intended a far-reaching integration of the Dutch and Italian airline companies and a full merger in 2002. Both companies agreed to share 93 percent of Alitalia’s profits and 85 percent of KLM's profits and to take joint decisions about the fleet. The partnership got off to a dynamic start and promised to grow, also because of the connection with NWA, into a serious alliance that might compete with Oneworld, Skyteam or Star Alliance. In November 1999 both companies negotiated this with the Spanish Air Europe. In the end, the Italo-Dutch cooperation ended in a fiasco. The necessary privatization of the Italian state-owned company was not carried out as was agreed. (KLM, minutes supervisory board 25-7-2001 and 31-10-2001).

**Merger of all mergers**

After the failed adventure with Alitalia, KLM executives still recognized that the airline had to become part of a large European company. Both British Airways and Air France approached KLM in 2001 to explore the possibilities of a merger. In both cases there were some major objections. After the nationalization in 1945, Air France was still for the largest part state owned, which meant that a merger did not seem opportune for the further privatized KLM. On the other hand, the British airline imposed many conditions, which would inevitably cause problems in the balance of power. Therefore, the exploratory talks with British Airways were soon interrupted. In
the meantime, finding a partner became increasingly urgent. The crisis that broke out after the terrorist attacks of 9-11 led to the loss of thousands of jobs at the head office in Amstelveen and at Amsterdam Airport Schiphol. Shortly after the cancellation of the negotiations with British Airways, the two airlines coordinated their flight schedules on the routes to the Middle East because the number of passengers had fallen sharply. KLM showed there was still room for negotiation. British Airways maintained its interest and contacted the Amstelveen board again.

KLM now realized that an explicit choice had to be made between the British and French airlines and thus for the Oneworld or Skyteam alliance. In the negotiations that took place in the first half of 2003, the French had a significantly faster pace. They wanted to achieve financial integration as soon as possible. To have success they had to slow down. Following the successful British-Dutch tandem Royal Shell and Unilever, and the more recent mergers of Reed-Elsevier and Hoogovens-British Steel, the British were seen as a 'natural consolidation partner' (Van Os 2009). British Airways proposed a 'light model' cooperation, with a very gradual integration of both airlines. KLM did not publicly indicate which of its two competitors was favorite, but Air France was clearly the preferred choice indoors (KLM, minutes supervisory board 7-5-2003). The connections that could be made within Skyteam were more complementary than those that would be possible in Oneworld. The fact that the French also had an open-skies agreement with the US also favored Air France. In the end, the choice was simple, because in the summer of 2003 British Airways declared it wished to refrain from cooperating with KLM and to concentrate on a merger with the Spanish airline Iberia (KLM, minutes supervisory board 28-8-2003, 17-9-2003).

Negotiations on the merger with Air France now went smoothly. A cross-border merger of airlines had its own dynamics, in which the interests of both merger partners as well as those of the Dutch and French governments played a role. Landing rights had to be guaranteed and the national and economic concerns of KLM and its base Amsterdam Airport Schiphol had to be taken into account. More issues had to be solved. For example, the continued existence of KLM's cooperation with NWA and also with Continental Airlines, with which KLM concluded a second agreement in 2001, enabling it to fly to even more destinations in the United States, had become uncertain. Because Delta Airlines was part of the Skyteam alliance, the strict American anti-trust legislation could well have objections against the amalgamation. But also in Europe there were still major uncertainties arising from the intention to merge. Both airline organizations had to be convinced, national governments had to cooperate and competition authorities had to give their
consent to the cooperation. One particular point of attention concerned Alitalia, which was initially also involved in the cooperation, because the Italian airline and Air France were linked by an exchange of shares. In the end, this proved not to be a feasible option. Alitalia, with which KLM did not have such good experiences in the recent past, should first become more profitable and further privatized. So it remained with KLM and Air France, which as operating companies were placed in a holding company. The shareholders of Air France received a 37 percent interest, those of KLM 19 percent. The French government retained the remaining shares, though agreements were made on further privatization. The fact that Air France was the dominant party was also evident from the occupation of the board of the new company. The French CEO Jean-Cyril Spinetta became CEO, with Van Wijk as second man. Ten of the other board seats came into French hands, while KLM was allowed to delegate four more representatives in addition to Van Wijk. Finally, one seat was reserved for Alitalia (KLM, minutes supervisory board, 28-8-2003, 17-9-2003 and 22-10-2003).

At the end of September 2003, Van Wijk and Spinetta formally announced the collaboration worldwide, and two weeks later both managers signed the agreement to pave the way for the formation of the new company Air France-KLM. Both airlines switched to full code-sharing, flight schedule coordination, integrated pricing, joint lounges and coordination of ticket sales. KLM joined Skyteam. Also cargo networks were connected, frequencies increased and efficiency measures announced. Finally, by working together in purchasing and selling, important cost advantages could also be realised in Engineering & Maintenance (KLM, minutes supervisory board 17-9-2003). In the months that followed, both companies worked hard to implement the agreements. KLM conducted negotiations with the trade unions and the works council, finetuned the comprehensive Framework Agreement and consulted various competition authorities. On 5 April 2004, the prospectuses in which Air France made its takeover bid for KLM shares could be distributed among the shareholders. Exactly one month later, a triumphant Van Wijk reported that more than 90 percent of KLM shares had been offered and the Air France-KLM Group was founded. Van Wijk and Spinetta rightly spoke of a 'landmark event': the largest airline in the world. Joining Skyteam, in which NWA and Continental now also participated, was an important milestone that once again broadened KLM's scope. The nine airlines that at that time belonged to this alliance together transported no less than 341 million passengers a year, with 14,320 daily departures to 658 destinations around the world in more than 130 countries. KLM had finally
gained a place in one of the three major airline alliances (KLM, annual report 2004-2005; minutes supervisory board 20-7-2004).

Advantages and issues

The merger was launched energetically. There were many synergy benefits to be gained, as demonstrated by network modifications. For example, the low-profit KLM service to Caracas was discontinued and Air France, which was already flying daily to Venezuela's capital, increased its capacity. Air France, on the other hand, was able to stop using the so-called *tail end* Singapore-Jakarta, because KLM was already flying to Jakarta daily via Kuala Lumpur or Singapore. Coordination within Europe took also place. Fifteen flights from the Paris airport Charles de Gaulle to Amsterdam Airport Schiphol were organized in such a way that transfer passengers no longer had to stay one night at one of the two airports before transferring to an intercontinental flight. The yields - the profit per seat - improved, partly due to the efforts of the French sales organization, which now also sold KLM destinations that Air France did not fly to. Important synergy benefits were also achieved in the other business units - cargo and Engineering & Maintenance. It should be noted that the merger took place under favorable time conditions. Around 2004, the airline industry benefited from the economic boom and increased purchasing power, which resulted in a stronger increase in demand. The performance of the Dutch airline improved year on year until 2008. KLM's operating result in the 2003-2004 merger financial year was still 120 million euros, but four years later it had risen to over 750 million euros. These excellent results surprised both friend and foe (KLM, annual reports 2003-2008, minutes supervisory board 24-9-2004).

KLM’s membership of Skyteam was considered an important advantage of the merger. Skyteam developed into the second alliance of the world in both size and scope. It enabled KLM to offer its passengers a larger number of connections to all corners of the world.
Table 2: Skyteam, OneWorld and Star Alliance in 2012

<table>
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<tr>
<th></th>
<th>SkyTeam</th>
<th>OneWorld</th>
<th>Star Alliance</th>
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<tbody>
<tr>
<td>Members</td>
<td>15</td>
<td>12</td>
<td>27</td>
</tr>
<tr>
<td>Number of aircraft</td>
<td>3542</td>
<td>2315</td>
<td>4023</td>
</tr>
<tr>
<td>Pass/year</td>
<td>487 million</td>
<td>304</td>
<td>604</td>
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<tr>
<td>Destinations</td>
<td>926</td>
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</tbody>
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The merger turned out to be a success during the first years. The formula for this success was a high degree of freedom for each airline. The AF-KLM Group did not aim full integration from the outset. Many activities remained entirely independently managed by the two airlines. Further integration only took place if there were good reasons to amalgamate business units. The two Cargo divisions were quickly merged into a so-called Cargo House, which created a management structure above the two operational cargo units. This was a logical step for the Cargo departments, where branding played only a limited role and flexibility and price levels were of decisive importance when acquiring customers. This was different for passenger transport, where the cooperation was initially limited to eliminating the overlap in networks. In addition, the joint frequent flyer program *Flying Blue* was introduced, replacing the Dutch *Flying Dutchman* program and the French *Fréquence Plus* program. It was only in 2007 that a gradual integration of passenger transport took place, which was necessary to generate higher revenues. The foreign sales offices merged. This strategy, in which the two airlines worked together wherever possible, but kept their own profile, gained much admiration (Noorderhaven 2008). While other cross border mergers were often less successful due to conflicts of interest between the different parts of the holding company, stress to integrate or cultural diversity, KLM and Air France operated more or less as autonomous enterprises (Van Os 2009; Bensdorp 2012; Bouwens 2018).

In the early years of the merger, economic growth and increasing globalization were favorable for the two cooperating airlines. This changed when, in the autumn of 2008, a financial and economic crisis broke out that spread around the world like an oil slick. The world entered the deepest economic crisis since the Second World War, drawing parallels with the Great Depression of the 1930s. For KLM, the consequences were soon noticeable. Yields went down and revenues - just like those of competitors British Airways and Lufthansa - fell by more than twenty percent in 2009. Cargo in particular suffered greatly from the deteriorating economic
conditions. The operating result plummeted. While the 2008-2009 financial year still had a modest plus, the following year a loss of almost 300 million euros had to be recorded. According to the CEO of AF-KLM, Pierre-Henri Gourgeon, who took office in 2009, it was an ‘annus horribilis’ (KLM, annual report AF-KL 2009-2010). KLM responded to these losses with a series of cuts and measures that were intended to increase productivity. According to KLM, generating more income could mainly be achieved through cooperation within the group. In the field of Engineering & Maintenance in particular, there was a lot to be gained. The five-year-old merger was therefore not only the answer to deregulation and consolidation in the aviation sector, but it now also offered new opportunities for coping the crisis. The collaborations with NWA and others also proved worth their weight in gold. NWA joined Delta Airlines in 2008 and became part of the largest airline in the world. Where other airlines ran into serious problems - 4500 people had to leave SAS, Austrian Airlines shrunk sharply after the takeover by Lufthansa, Alitalia more than halved and Finnair ceased non-stop flights to America and China - Air France-KLM performed relatively well through this European-American alliance. Although growth in the European markets was limited, KLM and its partners scored significantly better than the competition on the transatlantic routes and also to Latin American and Asian destinations, regions where growth was significantly higher (KLM, annual report 2008-2012; Lieshout 2009).

The crisis and the need to cut back costs did not accelerate integration. KLM retained its own identity and both companies aimed to maintain the balanced character of the cooperation. Nevertheless, there were major concerns at KLM’s head office. The fear that the French would play off their majority shareholding in the group and sidetrack the Dutch directors remained. From 2012 onwards, tensions slowly but surely increased. This was caused by the performance of Air France, which lagged far behind the operational results of KLM. In 2016, KLM’s profit of 681 million euros was almost twice as high as that of the much larger Air France. Cultural differences, which already had been recognized in 2003 were now regarded as the culprit. The fear that Air France would now take over power ebbed away when the Group presented its ‘Trust Together’ plan in the summer of 2016 (KLM, minutes supervisory board 8-12-2016). However, the relief was only temporary. In 2019, the French desire for further integration and more control led to a serious corporate crisis between the CEO of KLM and the CEO of the Air France-KLM group. In February 2019, the Dutch government even took a 14 percent stake in the holding AF-KL to prevent the Dutch interests of KLM from being undermined.
**New competitors**

The merger of KLM and Air France marked the start of a series of international mergers and acquisitions. The airline industry consolidated at a high pace. Large companies participated in smaller companies or took over foreign competitors. German airline Lufthansa was very active in this area and acquired, among others Austrian Airlines; British Airways and Spanish Iberia merged in 2010. Most of these consolidations were prompted by the desire for economies of scale, cost savings and network expansion.

The cooperation and the increasing integration of the industry offered no guarantee for a untroubled. With the liberalization of the market, new competitors emerged that successfully competed with the existing airlines, using alternative business models. Especially the so-called low cost carriers (LCCs) were tough competitors. These new companies first emerged in the United States, but European entrepreneurs soon saw opportunities as well. Freddy Laker was an early example of this with his Skytrain. At the end of the seventies he offered transatlantic air tickets at a price more than sixty percent below that of the national flag carriers. His Skytrain forced the established order to adjust their fares (Bouwens and Dierikx 1997). In the 1990s, many companies changed their business model and several new companies emerged. Unlike the established airlines, these newcomers only carried passengers who booked a ticket at a low fare, but with a minimum of facilities. These passengers usually departed from a regional - and for the airline cheaper - airport. The main difference was that these airlines flew from point to point and did not have a network. Their revenue model was not only based on passenger transport, but also on commissions from hotels and car rental companies, additional baggage charges, telephone services and the sale of products on board. Ryanair, the best known and largest LCC, made a net profit of €302 million in 2005-2006, of which €259 million came from activities unrelated to ticket sales (MIG 2006; Cento 2009). In addition, LCCs kept their costs low by standardizing equipment and keeping working conditions sober. The fact that this new business model for aviation was in reality not as simple as it seemed to be was demonstrated by the large number of bankruptcies among the new airlines that occurred in the first years of the new millennium. Some larger low-cost carriers took over the ailing airlines. The vast majority of companies with significant names such as AirLib, GetJet, FlyingFinn or Goodjet were only short-lived (Cento 2009).
The LCC concept was in line with the demand for cheaper airline tickets, which consumers could now easily order themselves after a comparative survey via Internet. In 2005, seventy percent of all passengers in Europe flew with Ryanair, Easyjet or Air Berlin. The Irish low-cost airline Ryanair already carried more passengers than KLM in 2003. In 2017, nearly thirteen million people bought a ticket from Ryanair, more than twice as many as from the largest European network company Lufthansa (see graph 3) (WATS 2003-2017).

The expansion of the LCCs became a serious threat to KLM and other European flag carriers. Initially, the Dutch airline trusted in the strength of its own network and the facilities if offered to the customers that flew via Amsterdam Airport Schiphol. KLM realized that passengers were mainly looking for cheaper tickets, but instead of adjusting the rates, KLM invested mainly in the service provision. Larger baggage bins were added to the B-737, the self-service check-in was introduced and the company ordered better quality headphones for the in-flight entertainment system. However, the renewal of the interior with, among other things, ultramodern flatbed seats or the expansion of the loyalty programme did not appear to be what most passengers were waiting for. KLM had to find an answer to the challenge posed by the LCCs, as more than 65
percent of its income came from passenger transport (KLM, minutes supervisory board 12 and 13-9-2001).

Under the slogan 'Be a smart follower' KLM founded its own LCCs Buzz Air in 1999 as part of KLM UK, and Basiq Air, which came under the Transavia flag. In 2003, however, KLM sold Buzz Air's orange painted aircraft to Ryanair and two years later Basiq was merged into Transavia. Transavia, in which KLM had an interest since 1991, now became a full subsidiary of KLM and was transformed into a low cost carrier. In addition to being a feeder for KLM's long-haul intercontinental flights and its long standing charter trips to the sun, Transavia focused on city trips, a market in which LCCs had a strong position (KLM, annual reports 1999-2012; KLM, minutes supervisory board 6-5-2003, 10-1-2012).

The low cost carriers competed with network airlines such as KLM on European flights. This was different in case of new airlines from the Middle East. With Emirates at the forefront, founded in 1985 by the United Arab Emirates, these airlines achieved enormous growth figures with the support of the state and facilitated by impressive airport infrastructure. Dubai Airport increasingly acted as a hub. For the transport of passengers and cargo between the United States and Asia, a stopover in Europe was no longer a matter of course. Emirates and Ethihad, founded by the Abu Dhabi government in 2003, developed into formidable competitors. The aggressive pricing policy of these companies and the enormous capacity expansion - Emirates had more than 240 aircraft on order in 2018 - were a cause for serious concern for KLM executives. Between 2008 and 2015, the number of passengers carried by these Gulf airlines increased by no less than 117 percent to 81 million. Air France-KLM grew by only four percent in the same period and carried 77 million passengers in 2015. Even more impressive were the Gulf companies' cargo performance. After the 2008 crisis, Emirates developed into one of the world's largest freight carriers. The performance of European airlines in this field was poor (see graph 4) (Annual reports Emirates Group 2017-2018; WATS 2003-2017; KLM, minutes supervisory board 20-2-2013, 21-4-2017).
**Conclusion**

The merger Air France – KLM in the spring of 2004 was the first cross-border merger in the airline industry. It was not the first time that the Dutch airline was a kind of innovator. With the introduction of the hub and spokes system, the airline also showed the way and the cooperation with NWA in 1989 was unique at that time. Using the changing legal frameworks, that facilitated globalization, KLM responded to the opportunities offered by deregulation. However, this liberalization also increased competition within the industry. KLM formulated a strategy of cooperation that kept the company - in contrast to various other European flag carriers - in the air. The benefit was only temporary. The competitors did not lay back and joined forces to form global alliances. Consolidation did not decrease competition. On the contrary, KLM saw the entrance of new airlines that gained a foothold in the market thanks to liberalization and making use of new business models. Air France-KLM responded by strengthening the Skyteam alliance and thus expanding the network, and imitating the LCCs by carrying out cheap flights itself. The success of the first cross-border merger was due to the fact that both airlines kept their own identity. Within the AF-KL group two distinct airlines continued to exist, each with its own brand and profit responsibility. For years this was seen as the formula for the success of the merger. In
recent years the cooperation has been under pressure because of the unequal results of both airlines and the gradual imbalance in management and control. In February 2019, the Dutch government took an important stake in the AF-KL group to safeguard the interests of the Dutch economy. It can be seen as a paradox in the scene of deregulation, liberalization and globalization, and another indication of shifting interests towards deglobalization and protectionism.
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