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Code-sharing lifeline for troubled airlines

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JAPAN Airlines (JAL) is teetering on the verge of bankruptcy, as the Japanese government desperately seeks a way to rescue it. Between January and December last year, JAL shares have fallen 69 per cent to 67 yen per share, erasing 404 billion yen (S$6.1 billion) in market value.

JAL is one of Japan's two flag carriers, the other being All Nippon Airways. JAL is a member of Oneworld, one of three major international code-share alliances. The two others are Star Alliance and SkyTeam. Oneworld includes American Airlines, British Airways and Cathay Pacific. Star Alliance includes United Airlines, Singapore Airlines and All Nippon Airways. SkyTeam - which includes Delta Airlines, Air France and KLM - stands out for not having a Japanese member.

In mid-November last year, Delta and the SkyTeam alliance offered JAL a US$1 billion (S$1.4 billion) financial package, comprising US$500 million in capital investment, US$300 million in short-term revenue guarantees, and US$200 million in asset-backed financing. This was conditional on JAL switching from Oneworld to SkyTeam.

Within days, American Airlines tabled a counter-bid, offering up to US$1.1 billion to keep JAL in Oneworld. American Airlines asserted that, through closer cooperation, JAL could increase code-share revenues by about US$100 million a year, in addition to the US$500 million it was already earning.

Why are United States airlines, themselves financially stressed, bidding a billion dollars for a nearly bankrupt airline? The competition to woo JAL has brought into focus the anachronistic regulation of international airline services and the role of code-sharing as a workaround to such regulation.

After World War II, global air services have been regulated by respective governments via bilateral air services agreements. These agreements specify the number of flights their respective flag carriers can fly between two countries. They also regulate details such as the size of aircraft and whether airlines can pick up passengers for onward destinations.

So if a US carrier wants to increase flights to Japan, it must secure permission under the US-Japan bilateral agreement. Once the flights authorised by the bilateral agreement are fully used, there can be no further expansion - whatever the demand might be.

The obvious purpose of such regulation is to protect national 'flag carriers' from competition and maintain high profits. The implication for consumers is higher fares, fewer choices and a lower quality of service. Just compare the Kuala Lumpur-Singapore air services market before and after the 'revenue pool' between Malaysia Airlines and Singapore Airlines was dismantled.

In international air services, as in many other markets, the trend is towards deregulation and opening up to competition. Liberalisation began in the US domestic market. It led to intense competition and consolidation among the so-called network carriers like American Airlines, Delta Airlines and United Airlines. Most recently, Delta acquired Northwest Airlines.

The European Union followed suit. France, for example, acquired Dutch flag carrier KLM, and British Airways is in talks to acquire Iberia of Spain.

However, liberalisation of international air services has been relatively slow. In particular countries, the limits set by bilateral air services agreements have been seriously exacerbated by capacity constraints at major airports.

One reason international airlines are buying the mega Airbus A-380 is to maximise their use of limited take-off and landing slots at 'slot constrained' airports such as England's Heathrow and Japan's Narita. Until recently, the Japanese government had limited all Tokyo-area international flights to Narita Airport.

In such a context, how can foreign carriers expand their business into countries subject to restrictive bilateral air services agreements? The answer: code-sharing.

As any seasoned air traveller will know, an international airline flight today may share codes of multiple airlines. For instance, American Airlines flights AA5816, AA5820 and AA5822 from Narita to San Francisco, John F. Kennedy and Chicago O'Hare airports are code-share flights operated by JAL.

Through code-sharing, American Airlines may sell a seat on a JAL flight, earning the revenue from the passenger, and sharing part of it with JAL. So American Airlines expands its effective capacity despite the existing Japan-US bilateral agreement or capacity constraints at Narita. Lacking a code-sharing Japanese partner, Delta Airlines cannot avail itself of this stratagem.

The more restrictive the bilateral agreement and the more limited the airport capacity, the more valuable the code-sharing. Hence, the scramble between American and Delta to buy JAL's membership in their respective alliances.

In the long term, hopefully, governments will liberalise air services to multilateral trade - just as they have done with trade in goods through the World Trade Organisation. Then, carriers like JAL will sink or swim on the economics, not grandfathered rights handed out by some past government. But that is in the long term.

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