The Qantas Air New Zealand Alliance

A conceptual & empirical assessment

Steven A. Morrison and Clifford Winston

Financial Success in the Airline Industry

- Low costs
- Excellent execution of service
- Innovation in operations and marketing

Financial Success in the Airline Industry

- No consistent source of rents
- Efforts to obtain market power do not lead to success
- There are major differences among carriers

Role of Mergers in Financial Performance

- All mergers are a risky investment
- Their prime motivation in the US is to acquire international routes and to relieve financial distress

Portion of merger activity attributable to key variables

Variable	1995
Operational and financial considerations	
Route density	2.8
Foreign routes	33.7
Aircraft type	1.8
Unions	1.7
Assets	28.1
Cash flow	3.7
Anticompetitive influences	
Price (revenue) increases	6.2
Common routes with fare wars	1.6
Industry-wide variables	
Interest rates (2 national carriers)	0.3
Interest rates (1 or more major carriers)	16.2
Predicted GDP	3.8

Effects of Airline Mergers

- Initial reduction in capacity replaced by low-cost carriers that place downward pressure on fares

AA & TWA	Elapsed quarters	Change in fares
	1	1.2%
	21	-2.9%
UA & NW	1	0.7%
	21	-1.7%

Effects of Airline Mergers

- Our retrospective assessments have tended to find reductions in fares, albeit with modest statistical reliability
- Mergers assessed:
  - NW and Republic
  - TWA and Ozark
  - US Air and Piedmont

An a Priori View of the QF-ANZ Alliance

- Its motivation is consistent with trying to ease financial distress as opposed to earning monopoly rents
- The Alliance faces potential entry from a low-cost carrier, Virgin Blue
- The Alliance could also face competition from other entrants (Emirates Air)

Key Empirical Issues: Virgin's Competitive Discipline & Entry Behaviour

- A fare equation for Australian routes indicates that Virgin's presence reduces Qantas' fares roughly 11%

Estimation Results: Fare Model

Variable	Coefficient	T-stat
Constant	-0.0859	-0.0357
Route distance	0.4231	20.3407
Product of O&D GDP	0.1064	0.9102
Carrier presence: Ansett	-0.0629	-6.5673
Carrier presence: VB	-0.1118	-4.1847

Comments

- Virgin has a bigger effect than Ansett on Qantas' fares even though Ansett had a bigger market share
- Price competition is inextricably linked with the provision of capacity (frequency)
- Competition supplied by low cost carriers often goes beyond competition on the route to include airport presence (potential entry) and presence on adjacent routes

Entry

- We also find that Virgin is not deterred from entering routes served by Qantas
  - in our sample, all routes they served were served by Qantas

VB Entry Model

Variable	Coefficient	T-stat
Route distance	-0.000856	-1.5591
Carrier presence: Ansett	-2.578171	-1.7930
Carrier presence: Qantas	1.620614	1.5694
Product of O&D population	3.14E-7	1.0960

Final Comments

- Air NZ’s persistent economic losses suggest it will not impose much competitive discipline on Qantas
- Why allow Air NZ to continue to lose money if its operations can be combined with a more stable carrier?
- There is little downside risk because of additional entrants in New Zealand