BA clicks into shape for its Spanish steps
Kevin Done

British Airways has been slow out of the blocks, but it is finally joining the great airline consolidation game.

Its planned merger with Iberia would bring together the number four and six European carriers measured by market capitalisation and three and five by turnover.

The enlarged group would be cemented as the number three European aviation group behind Air France-KLM and Germany's Lufthansa, and most importantly it would take BA out of its increasingly limited position as a largely London-centric carrier.

A merged BA/Iberia would be one of the big three European players in world aviation, fully able to play a big part in the next stage of airline consolidation, whenever an eventual removal of international regulatory obstacles makes the formation of global carriers a reality.

For the moment, however, airline mergers and acquisitions remain focused within regional markets - for example the planned Delta Air Lines takeover of Northwest Airlines in the US, and in Europe the takeovers of KLM and Swiss respectively by Air France and Lufthansa.

This is the context of the planned BA/Iberia deal. Global deals are still blocked by national limitations on the foreign ownership of airlines, such as in the US where foreign entities can own no more than a 25 per cent voting stake in a US carrier.

For global links airlines have had to resort to the unsatisfactory device of creating marketing alliances, Oneworld, where both BA and Iberia are members, Star led by Lufthansa and United Airlines of the US and Sky-Team led by Air France-KLM and Delta.

Before BA can run it must walk, however, and if it can pull off a merger with Iberia, it could gain the necessary scale for later adventures.

It must hope that this initiative is more productive than its previous forays into the minefield of airline mergers and acquisitions, which have largely been unproductive, most notably its approaches earlier in the decade first to KLM, the Dutch national carrier, and later to Swiss International Air Lines.

The obstacles, whether from financial backers in the City of London, or from the regulators in Brussels and especially in Washington always seemed too great.

KLM was abandoned only to be picked up three years later by a grateful Air France.

Swiss was put down with BA showing no appetite to take on the challenge of restructuring the then struggling carrier. It was not willing to invest in Swiss and chose simply to relieve the airline of some of its take off and landing slots at London Heathrow, BA's global hub, and then to withdraw.

Swiss was subsequently picked up in 2005 by a grateful Lufthansa. The German flag carrier has since patiently taken two years-to fully consolidate the airline, which by now is achieving even higher profit margins than Lufthansa itself. The success of the Air France and Lufthansa deals goes a long way towards explaining why BA is ready to try again, this time with Iberia.

Willie Walsh, chief executive of BA since late 2005, has made no secret of his admiration of the progress made by Air France-KLM and Lufthansa in creating much larger than expected revenue synergies from then-enlarged groups, and in the softly-softly approach they have taken towards integrating the two airlines.

Aviation mergers historically have been bedevilled, for example, by the problem of merging workforces and in particular the respective pilot bodies in what remains one of the world's most highly unionised industries.

In one of the most notorious examples, US Airways, the product of America West's takeover of US Airways, is still unable, three years after the deal, to merge the pilot bodies. The problem of combining the pilot bodies has been a key hurdle to the Delta/Northwest merger.

Air France and Lufthansa solved the problem by ignoring it. By showing great sensitivity to potential political, cultural and labour rivalries they set about creating structures which did not seem too threatening to highly entrenched national interests.

The national brands have been maintained and further developed. Existing managements were left in place to run the day to day operations of the two airlines separately.

Necessary painful restructuring was already under way at KLM and Swiss. It did not come as a result of the merger.

The combination was achieved immediately at the level of the capital and the shareholders, but the integration of the operations has only proceeded very gradually, a model that BA and Iberia are likely to follow.

Neither Air France nor Lufthansa have tried to merge the operational workforces and most especially the pilots.

Jean-Cyril Spinetta, Air France-KLM chairman and chief executive, has gone to great pains first to build a relationship of trust between the Air France and KLM groups, before gradually embarking on more ambitious integration.

He was blessed by the timing of his deal, which fortuitously took place as the aviation sector was expanding and flourishing, allowing him to embark on his strategy of pursuing "profitable growth" free of the need for drastic cost-cutting.

The big benefits have come from revenue synergies from harnessing the power of the Paris and Amsterdam hubs to suck in traffic flows. BA and Iberia will seek to find some of the same magic in flowing increasing traffic through their respective hubs in London Heathrow and Madrid.

They have the great advantage that they are bringing together two relatively healthy operations.

They have both been profitable, have strong balance sheets and are well managed. Together they should be better able to deal with the ferocious challenges facing the global airline industry from the soaring oil price and the weakening demand for air travel in key economies, in particular in the US. But it will be a testing process and the outside environment will not help.

As Martin Broughton, BA chairman told investors two weeks ago, airlines are "up to our necks in perhaps the biggest crisis the aviation industry has ever known".

Fonte: Financial Times, London, July 30 2008. Companies International. p.17.