Partnerships have allowed airlines to circumvent restrictions to route rights and reduce capacity. Sophisticated revenue management systems further allow such co-operational agreements to improve yields and revenues. An example of this is in the US west coast market.

Benefitting from co-operative competition through code-sharing

The maturing aspects of the airline industry have been known for a long time. Professional innovation for route planners and revenue managers seems to be the last bastion in which creativity can be used to eke out every possible aspect of marginal revenue increase and passenger numbers.

Living in a competitive world is nothing new to those in the airline business, but when one has the ability to start working together all sorts of opportunities arise to satisfy customers and shareholders. This is particularly true in the arena of traffic and revenue. One classic example of where co-operative competition has allowed previous adversaries to benefit all round is the west coast corridor between Vancouver and California.

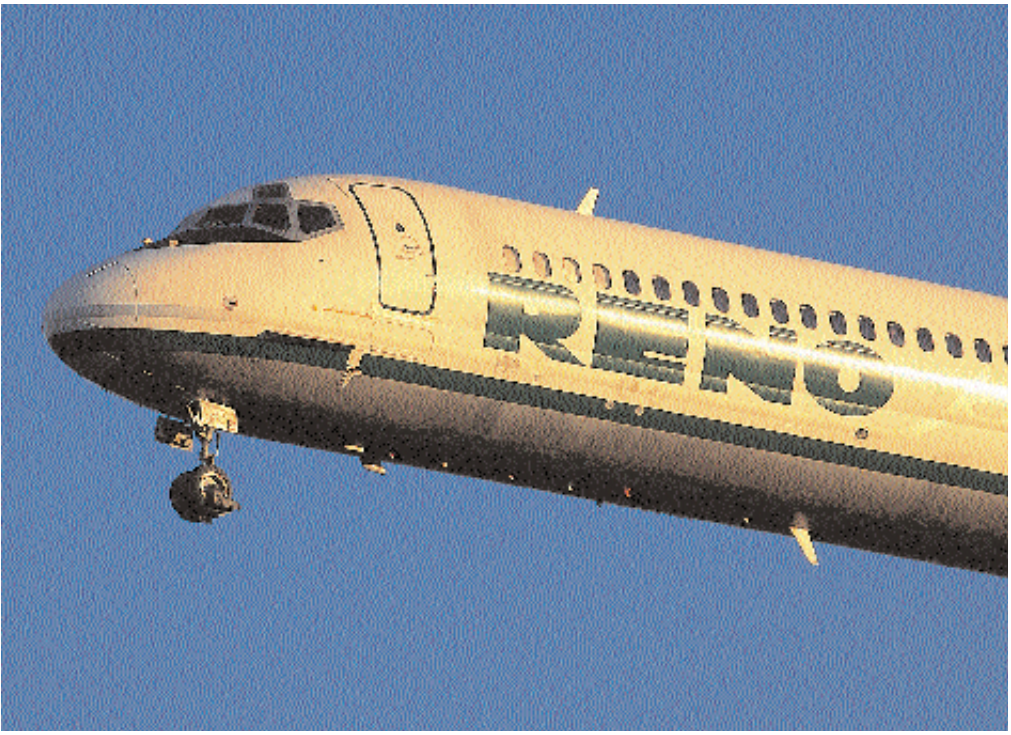
West coast north America

Vancouver has played a significant role as a major air transport hub and the most important hub to Canadian Airlines International (CP) as a gateway to Asia, for the Pacific northwest.

The city also has a significant in-bound tourist industry as a winter recreational area, combined with the infrastructure of a major cruise port for ships bound for Alaska in the winter. Although the city serves principally as a Canadian hub for domestic and international flights, it also has competition for trans-Pacific traffic from the SeaTac Airport in Seattle, only about 100 miles away.

Over the past few years the trans-border US-Canadian market has been influenced mainly by the introduction of the open skies agreement. At the beginning of the agreement, several years ago, secondary airports within Canada saw a significant increase in the number of flights to major American cities, only to have the service cut back or consolidated due to lack of demand. This is a prime example of where competition is not healthy in a thin market and a compromise has to be made by the competitors.

While Vancouver is principally a large hub airport, there are several markets that withstand a high degree of pure origin and destination traffic. The Vancouver-California market is a high density one which requires a high threshold frequency of non-stop flights to serve local business, tourist business and transfer connection markets feeding trans-Pacific flights to Asia. The market



Reno Air's entrance into the Vancouver-California market was one of many moves made by airlines after the open skies agreement was signed. Reno Air was subsequently bought by American; which also bought 25% of Canadian. American and Canadian also formed a code-share agreement. These processes reduced capacity; benefitting both carriers.

Alaska Airlines aggressively entered the Vancouver-California market after the open skies agreement was signed. It has so far managed to maintain most of the frequencies it started with in 1997. It has also formed a code-share agreement with Canadian on some routes.

has undergone some structural changes lately after a period of intense competition and is about to enter a period of mature co-operative competition.

Since an open skies agreement was signed, the airlines operating the Vancouver-California market have increased. This added frequency resulted in overcapacity. Airlines fought for market share, but followed the path of collaborative competition through code-sharing and reduced frequencies. This has been made possible with revenue management systems. As a result, yields in the market have improved.

Competition & co-operation

Although co-operation, otherwise known as code-sharing, has been around for many years within the airline industry, it is a term that has recently become widespread within other business sectors. This is where competitors join together on certain projects for the better of the industry as a whole.

Co-operation within a competitive role seems to take on a life of its own in the airline industry. This depends on how much several players wish to control the market, or to split passenger demand. We have seen the development of vast global marketing alliances and the proliferation of code-sharing in as many formats as there are revenue classes in the economy sections of airlines.

Computing technology now allows all players within the market the ability to purchase or rent highly sophisticated revenue management systems. These help them communicate and, most importantly, collaborate to better tweak the market to assist them into the ever-so-distant notion of continuous airline profitability.

At last the tools, the marketplace, the distribution systems and the influence of the Internet, seem to be converging whereby an increased level of control is coming back into the business as it enters its final maturing phase. No longer can any miracle tools be produced to fill seats and make each route profitable. Instead, all that is required is a common sense approach in order to work effectively and collaboratively.

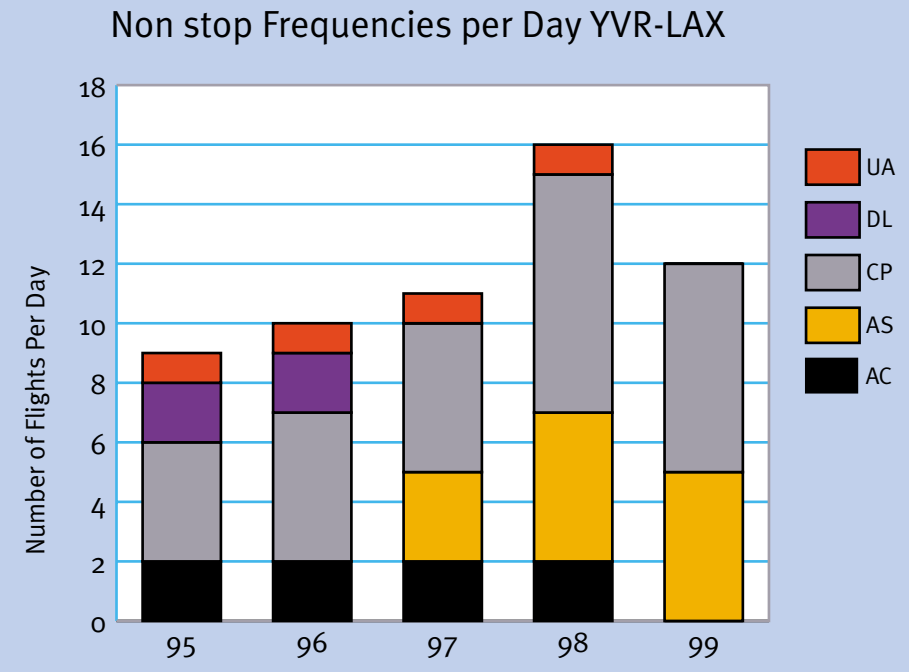
Collaboration in an ethical sense is the phase the industry is in now, where niche players will exist and non-stop markets will be dominated by a healthy set of players. Their fare structures can, and will, be influenced by competing carriers that have connection services through other cities. The evolution of market collaboration can be seen very effectively in the west coast corridor of Vancouver-California.

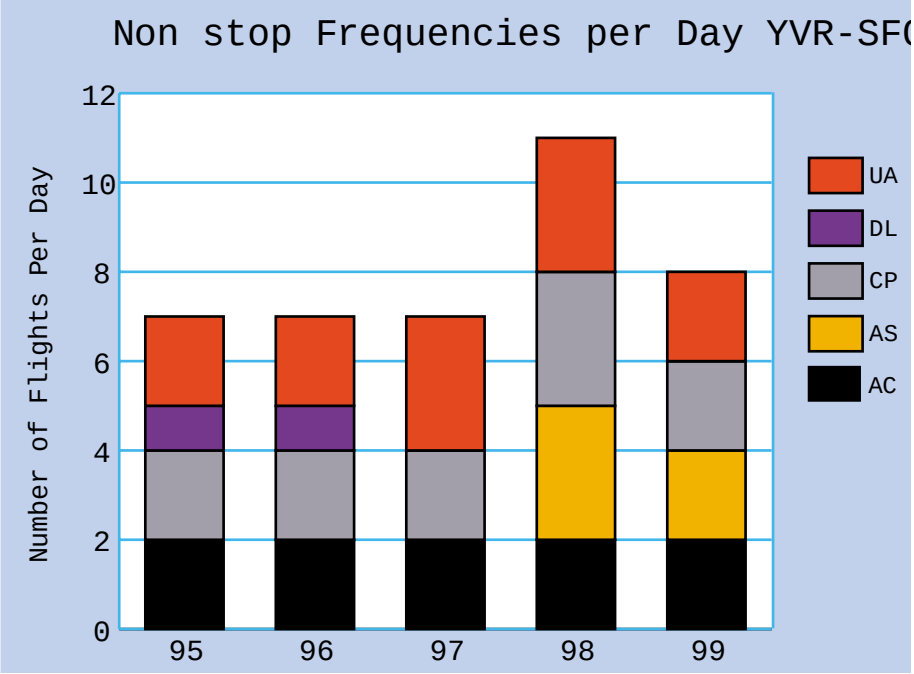
West coast corridor

The Vancouver-California corridor is one of the strongest trans-border markets in north America. The Vancouver-Los Angeles, and Vancouver-San Francisco routes rank fourth and ninth in the highest overall traffic for Canadian-US trans-border city-pair volumes.

The most recent total passenger volumes for the city-pair ranking shows that about 300,000 and 180,000 passengers move between Vancouver-Los Angeles, and Vancouver-San Francisco, respectively.

While they still represent a healthy market, the largest trans-border market in north America is the New York-





Toronto market, which has a passenger flow of about 800,000 per year for comparison. The Vancouver-San Diego route is quite small in comparison, at just 24,000 passengers.

A comprehensive analysis of flight schedules was undertaken to see how the market has undergone some structural and capacity changes in the past few years, and what influence collaboration between airlines has had on the market. As previously mentioned, the open skies agreement set the stage for change. Since then several developments have occurred that have had a direct influence on the west coast trans-border market.

American & Canadian

Several critical elements had an adverse effect on the west coast corridor. The first was the partial purchase of a 25% share of Canadian by American Airlines. This subsequently led to American code-sharing virtually all of its flights with Canadian in north America.

The second phase was the aggressive entrance of Alaska Airlines onto all the routes that Canadian served to the southwestern US.

The third element was the entrance of a discount carrier, Reno Air, to the Vancouver market, through connecting flights.

These elements provided a price-sensitive competitive effect to mature players which were already battling for market share in non-stop markets.

Four charts have been compiled using data from the *Official Airline Guide*. The charts show how the number of non-stop flights for each city pair have changed over the past few years since the open skies agreement was signed. They illustrate how some new airlines entered the markets, how some left and how others formed code-shares.

The markets analysed include: Vancouver-Los Angeles, Vancouver-San Francisco, Vancouver Las Vegas, and Vancouver-San Diego.

Each chart shows how the number of non-stop frequencies build and then reduce again as a new collaborative market agreement comes into place. The year 1998 was characterised by overcapacity and low yields on many of the routes. Low yields occurred because capacity outstripped demand and because of intense market competition. The yield versus marketshare battle played itself out last year. This summer's schedule seems to have brought sense back to the marketplace.

Vancouver-Los Angeles *(see chart, this page)* shows a steady increase in flights, with Alaska Airlines entering the market in 1997 and Delta Airlines dropping out. In 1998, Canadian Airlines boosted its frequency up to eight per day, while Alaska jumped its frequency from three to five from the year before.

In 1999's summer schedule only two airlines are participating in the marketplace and total market frequency. Subsequently the number of seats available in the market has dropped 25% over the past year.

Air Canada had entered the market for several years, then silently left in late 1998 after the resumption of its flight schedule following the pilot strike last year. Air Canada currently code-shares all its flights with United, since both are founding members of the star alliance.

Collaborative competition is what Canadian structured in a comprehensive deal with Alaska Airlines to code-share many of Alaska's flights and to allow members to accumulate points on Alaska flights.

This effectively gave Canadian access to 100% of the flights within the Vancouver-Los Angeles corridor in 1998 when there were four players in the marketplace.

Canadian is also ground handling the Alaska flights in Vancouver, further strengthening their alliance together. What is also notable from a scheduling point of view is that American Airlines only code-shares flight with Canadian equipment. This is so as not to confuse the issue of American code-sharing flights with Alaska through a Canadian Alliance.

Vancouver-San Francisco *(see chart, this page)* also saw a large-capacity growth during 1998 and a subsequent retrenchment back to a cosy relationship of four carriers.

Within this market Canadian code-shares flights with Alaska. This gives Canadian access to 50% of the non-stop

flights in the market. The chart shows how this arrangement has allowed Alaskan to reduce its flight frequencies in recent years. Delta has left the market, which is why it has no code-share partner in the market.

Vancouver-San Diego *(see chart, this page)* shows the growth of non-stop flights by Alaska, then the subsequent takeover of the frequencies by Canadian as Alaska drops out of the market.

The absence of a bar in 1999 indicates there are no nonstop flights available for the new summer schedule.

It seems the lessons of one carrier had to be learned by another in this market. San Diego does not support daily non-stop flights from Vancouver at sustainable yields.

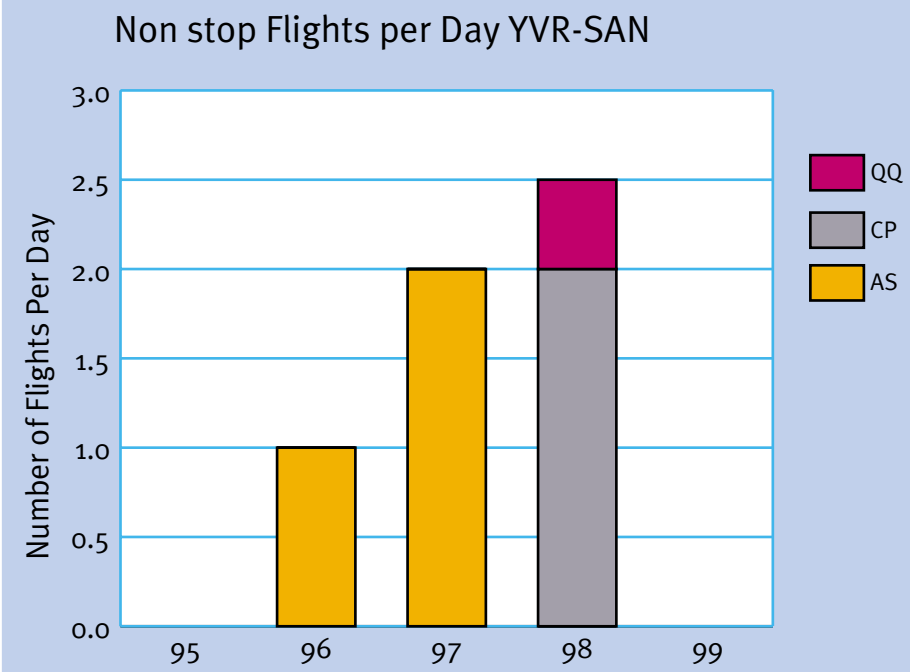
Reno Air (QQ) is shown in the chart as half a flight by a one-stop service through Reno city during 1998.

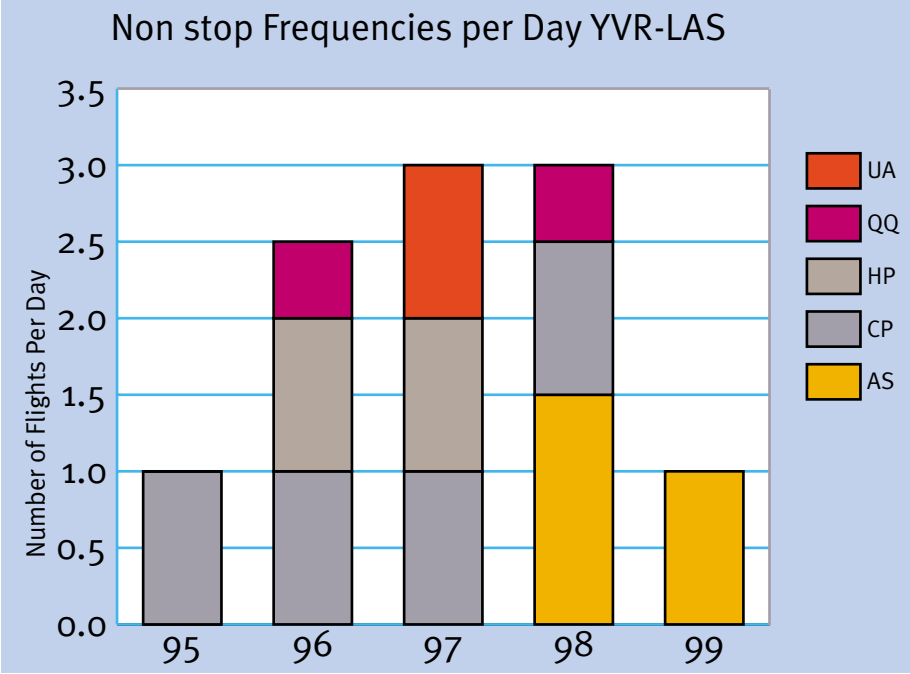
Vancouver-Las Vegas *(see chart, this page)* shows a steady growth of flights, with Alaska entering the market in 1998. The half frequency is shown by Reno Air as a one-stop flight. United entered the market briefly but pulled out in 1999.

America West competed in the market in 1996 and 1997, but later pulled out. It has not formed a code-share alliance with any of the other carriers in the market.

Reno Air made a brief appearance in 1998. Since then the airline has been bought by American, which subsequently bought 25% in Canadian. The two carriers formed a code-share alliance. Canadian also formed a code-share alliance with Alaskan.

In 1999 the market is served by one code-shared flight between Alaska and Canadian, on Alaska equipment.





Analysis

From the data of the past five years, we can conclude that overall frequency and available seats have not grown tremendously. What seems to be the case is that the market share versus load factor game was played in sacrifice to yields. In all markets available seat-miles have been reduced this year to allow carriers to raise yields and to provide for the basis of a cost recoverable operation.

The most notable reduction comes from the collaboration of the Alaska-Canadian alliance. Just one year ago the two were bitter rivals. Now it seems that when two groups work together they can better control their operations in a more beneficial manner. With American's recent purchase of Reno Air and the termination of Reno's Vancouver routes, yields are sure to be higher at the beginning of the new schedule season.

The airline community has seen alliances of every shape and form take place. The Canadian-Alaska alliance represented a large regional carrier forming an alliance with a partner with a significant presence close to its home market, and with a large hubbing operation. For consumers it meant access to more flights through code-sharing; so the benefits were good all round.

For the those who are extremely price-sensitive fares/yields are higher, but the prices that were available last year were unrealistic for the marketplace. Consumer advocates baulk at the idea of groups getting together, but collaboration between competitors is what is needed to sustain a healthy industry. Too much competition is simply detrimental to all the competitors.

The development and re-tooling of schedules to maximise transfer connections has definitely reaped the benefits of increased-capacity utilisation.

The Star Alliance and One World will definitely push the envelope to get alliance partners to work together. Lessons will also be learned with schedule co-ordination at US Airways and American. This is because both carriers use tools from Sabre technologies.

We are quickly reaching the pinnacle of schedule co-ordination and various forms of collaboration with co-competitors. The next cycle of the industry is to sort out the co-ordination of effective capacity management through these agreements. The Canadian-Alaska arrangement is a minor showcase. The outcome of this summer schedule will be the acid test of how the west coast-Vancouver corridor can be managed.

For more information on Canadian Airlines visit its web site at: www.cdnair.ca or Alaska Airlines at: www.alaskaair.com AC