KLM: Gaining altitude with alliances

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When one thinks of alliances, airlines often spring to mind. KLM was one of the first to give wings to global airline alliances that have been commonplace ever since.

KLM Royal Dutch Airlines, founded in 1919, is the oldest carrier in the world still operating under its original name. When it teamed up with Northwest Airlines in 1989, it also became the first to be credited with forming a major international alliance between airlines.

Even though the long-standing Northwest-KLM cooperation has often been at the forefront of joint venture studies over the past 20 years, many may not know that KLM has participated in over 100 other alliances.

Given KLM's seasoned veteran status in alliance formation, IESE professors [Africa Ariño](#) and Pinar Ozcan and research assistant Jordan Mitchell checked in with KLM's head of strategic alliances, Henk de Graauw, to learn more.

The case study, "The KLM Approach to Alliances," is itself part of a joint collaboration with the consultancy KPMG.

The authors examined several major milestones in KLM's long history of alliances, joint ventures and merger attempts. Their case covers the development of the KLM-Northwest relationship and the commercial success of the alliance, despite many well-publicized senior management disputes.

The case also contains some smaller joint ventures, such as KLM's alliances with Kenya Airways and China Southern.

Finally, it recounts merger attempts like KLM's early undertaking to create a pan-European airline with the four-member Alcazar alliance, negotiations to merge with British Airways, the merger and subsequent de-merger with Alitalia, and the successful merger with Air France in 2004.

The three types of alliances

KLM classifies alliances in three main categories: commercial or tactical partnerships; joint ventures; and multi-airline alliances.

The first type is usually a partnership with a smaller airline to offer a city pairing in a given geography. These tactical relationships are designed to feed traffic into Schiphol Airport or to provide a specific extension to a route. Examples of tactical relationships include KLM's relationships with Alaska Airlines in the U.S., Comair in South Africa, FlyLaL in Lithuania and TAM in Brazil.

The second category, joint ventures, is defined by longer-term partnerships that involve collaboration on a number of routes and call for the integration of sales and marketing functions as well as back-office support.

Unlike joint ventures in other industries, KLM does not necessarily set up separate formal entities in which assets are contributed by both sides. Rather, the joint venture is virtual in that both airlines continue to own their separate fleet of planes.

However, instead of taking decisions alone, they have a high degree of coordination in capacity planning and pricing. They split the profits of jointly run routes based on a 50/50 split, allowing for minor adjustments if one airline flies more than its partner. Examples of such joint ventures include KLM's tie-ups with Northwest, Kenya Airways and China Southern.

The third type is multi-airline alliances: KLM participates in the SkyTeam alliance along with 11 other full member airlines and three associate carriers. Under these broad alliance agreements, participating airlines are able to strengthen their own position by being connected with a large international route network and provide benefits to passengers such as collecting points on a frequent flyer program when traveling within the alliance.

KLM's six-step process

While every alliance is unique, KLM has a general six-phase approach to alliances: screening, scoping, contracting, implementing, developing and managing.

Screening is all about finding possible partners. Starting with desk research, a lot of alliances are born from a particular route network need. In other cases, airlines approach KLM directly to propose the possibility of working together.

As part of the screening process, which could take a number of months, executives from the two airlines meet, sign non-disclosure agreements, and exchange statistics and network details. Both sides would then go away to build the business case for an alliance, and if it looked profitable, KLM would move on to a safety and quality audit.

Upon the completion of the screening process, *scoping* would begin, whereby a memorandum of understanding (MoU) and initial joint business planning would occur. Legal staff would be brought in to identify any legal and cross-border issues. Other support functions like operations and information technology would also be looked at for how the two airlines could integrate with one another.

The third stage, *contracting*, focuses on the formation of a commercial agreement and a specific action plan. Agreements cover the scope of the partnership, the responsibilities of both sides, the governance structure, renewal, exit clauses and termination.

After the first three stages, the alliance transitions into day-to-day management. As the name suggests, *implementing* involves putting the contract into action and working through the necessary changes to kick-start the cooperation.

Often, this leads to an iterative *development* process, whereby further agreements would be made to enhance the functionality of the alliance.

Finally, the *managing* stage is an ongoing process to ensure that the alliance is delivering the expected results. Typically, KLM looks at measures such as the number of passengers or weight of cargo produced through the partnership and, of course, the financial results.

Having negotiated so many alliances, it's clear that KLM has gained altitude over peers when it comes to alliances.

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