Airline privatisation in Europe and industry dynamics: British Airways, Lufthansa, and Air France

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Abstract

This study examines the underlying processes behind the airline privatisation experience in Europe through the cases of three main European airlines, British Airways, Lufthansa, and Air France as well as the resulting developments in terms of industry dynamics. The study examines various privatisation processes, including intra-firm planning related to rationalisation and operational strategy to industry-wide developments, such as alliances and mergers. The framework of Competition-Cooperation-Consolidation ("3C's") is developed in this study to best represent how the post-deregulated industry has changed since the 1980s.

The study reveals that in terms of intra-firm dynamics, Lufthansa and Air France followed a similar strategy of rationalisation ahead of privatisation as that of the first fully privatised British Airways. The British Airways rationalisation strategy has become an industry standard for cost-cutting and pre-flotation recovery. Furthermore, Lufthansa and Air France have followed the British Airways post-privatisation scale strategy of investments, acquisitions, and code-sharing agreements with partnered airlines. The aim has been to survive 1990s liberalisation and the Single European Aviation Market 1997 competition drive.

In terms of industry-wide dynamics, all three airlines have developed their code-sharing agreements to pursue cooperation within the industry given the pressures of deregulation. These partnerships evolved into the three main airline alliances, Star Alliance, Oneworld, and SkyTeam. As a result, closer cooperation led to alliances and eventually mergers like the Lufthansa Group, with the aim of consolidating market power within the international market. Consequently, the "3C's" framework is exemplified as the common configuration that British Airways, Lufthansa, and Air France have followed and contributed toward.

This study also shows how the state has been involved in the privatisation process and since. A continued presence of the state in the functioning of these flag carriers has been noted despite privatisation due to strategic reasoning and, in the Air France case, political ambivalence related to privatisation. The most recent COVID-19 bailouts exemplify how the state continues to be involved, even if indirectly in the case of British Airways, often leading to a "too big to fail" type scenario and flag carrier favouritism. This aspect brings about concerns about continued government intervention within industry, resulting in distorted competition accusations.

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Abbreviations

3C	Industry Framework of Competition-Cooperation-Consolidation
AF	Air France
AN	Archives Nationales de France
BA	British Airways
BAC	British Aircraft Corporation
BCal	British Caledonian
BEA	British European Airways
BMA	British Midland Airways
BOAC	British Overseas Airways Company
BSAA	British South American Airways
BT	British Telecom
CAA	UK Civil Aviation Authority
CDU	The German Christian Democratic Union Party
CSU	The German Christian Social Union in Bavaria Party
DLH	Deutsche Luft Hansa Aktiengesellschaft
DM	Deutsche Mark Currency
ECAA	European Common Aviation Area
EEC	European Economic Community
EU	European Union
FPD	The German Free Democratic Party
IAG	International Airlines Group

IATA	International Air Transport Association
ICAN	International Commission for Air Navigation
ICAO	International Civil Aviation Organization
IMF	International Monetary Fund
IPO	Initial Public Offering
ITA	Italia Trasporto Aereo
JAL	Japan Airlines
KLM	Koninklijke Luchtvaart Maatschappij (Royal Dutch Airlines)
LCC	Low-Cost Carriers
MALIAT	Multilateral Agreement on the Liberalization of International Air Transport
MTFS	UK Medium-Term Financial Strategy
NAO	UK National Audit Office
PICAO	Provisional International Civil Aviation Organization
PSBR	Public Sector Borrowing Requirement
PSDR	Public Sector Debt Repayment
SAEF	Le Service des Archives Économiques et Financières (The French Economic and Finance Archives)
SAS	Scandinavian Airlines
SPD	The German Social Democratic Party
TE	Technical Efficiency
UTA	Union de Transports Aériens
VBL	Versorgungsanstalt des Bundes und der Länder (The Federal and State Government Employee Retirement Fund)

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Author’s Declaration

I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has been submitted only for the dual PhD degree at the University of Glasgow/Kyoto University and not for any other degree at the University of Glasgow, Kyoto University, or any other institution.

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Signature:

Chapter 1. Introduction

Since the 1980s, privatisation has been employed as an important tool to supplant state involvement within the running of industry. In essence, contemporary European governments have embraced market forces and deregulation, including privatisation, as the dominant form of organising markets because of their perceived superiority in the efficient running of industry. They have done so by selling companies to private ownership and subjecting these newly-privatised firms to competition in the hopes of better economic outcomes. Airlines have been an important part of this substantial development given their increased economic importance. Yet, the processes and dynamics behind airline privatisation continue to be understood only to a surprisingly limited extent.

As a result, this study is concerned with portraying the airline privatisation experience in Europe and its various processes, ranging from privatisation preparations to rationalisation and operational strategy to flotation elements and, most recently, to the ongoing role of governments in the context of the COVID-19 pandemic. It does so by looking at the cases of three main European airlines as they have prepared for privatisation: British Airways (BA), Lufthansa, and Air France (AF). These are chosen given their centrality to the European airline privatisation drive, the different timings of their privatisation, as well as their role at the forefront of industry developments. By analysing their experiences, the study contextualises the European airline privatisation experience as well as the industry dynamics surrounding these processes.

Industry dynamics are defined in this study as the wide range of changes in structures and mechanisms within industries over time, paying attention to industry specificity, and targeting the level of industry related to how firms and national economies shape these developments.

This study answers three main questions:

- What were the main processes behind the European airline privatisation experience? How did these develop over time?

- How have these processes informed the developments in industry dynamics both at the flag carrier and industry-wide levels?

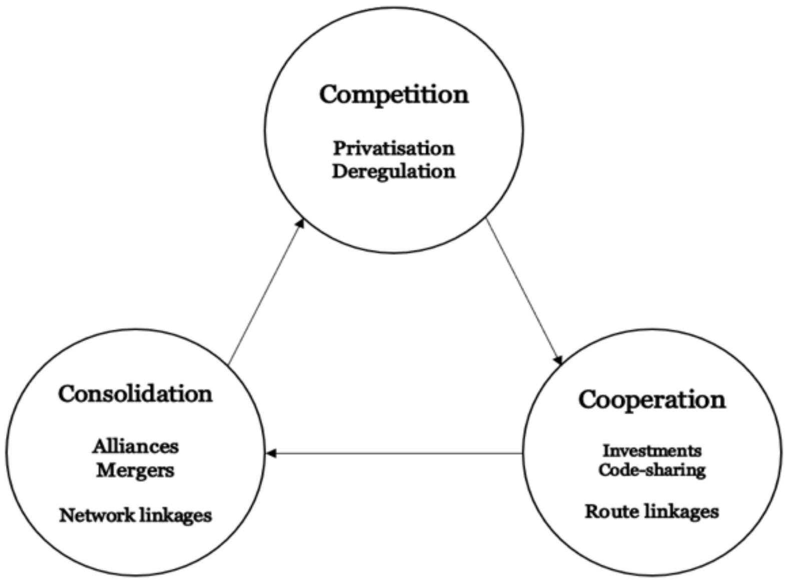
- How has the relationship between flag carrier and government developed as part of the privatisation process?

The analysis focuses on airline data 10 years before, during, and 10 years after privatisation, although it also provides an overview of the changes at the airline and industry before and since. The airline privatisations are discussed in a chronological manner as they occurred: starting with BA and a focus on the 1980s, following with Lufthansa during the late 1980s and early 1990s, and then by AF during the 1990s and since. As Chapter 2 discusses the industry pre-deregulation and privatisation, the analysis starts before the 1980s.

Such an analysis is possible by considering the questions through the perspectives of dynamics within the firm and industry, the role of the state within the airline before and after privatisation, and the specific processes of privatisation including flotation preparations.

For the dynamics perspective, the study considers intra-firm airline privatisation preparations involving rationalisation programmes and scale strategies, as well as industry dynamics represented through the creation of the "3C's" framework (Competition-Cooperation-Consolidation) (Figure 1.1).

Figure 1.1 Post-deregulation "3C's" framework of the airline industry.[1]



[1] The author's own representation of the deregulated airline industry.

This study introduces the “3C’s” framework as an original representation of how privatisation and deregulation measures have instilled greater market discipline among European carriers, leading to increased competition, cooperation, and consolidation. It is developed from the analysis of the three largest European airlines, BA, Lufthansa, and AF and the commonalities of their experiences presented in this study. All three flag carriers had to face the **competition** from new market entrants during the 1980s and 1990s European deregulation drive in the sector and the self-discipline of surviving this competition in the context of privatisation. Privatisation meant that these carriers could seemingly not depend anymore on aid from their governments. This competitive threat pushed these flag carriers into a 1990s scale strategy where **cooperation** through investments, take overs, and code-sharing agreements with other airlines was imperative for survival. Pronounced cooperation led to **consolidation** through the establishment of the three largest airline alliances as well as the first European mergers during the late 1990s and early 2000s, respectively. This consolidation movement established a worldwide network between alliance members favouring the consolidation of market power. This framework is discussed throughout the study and returned to in subsequent chapters as well as the conclusion. A breakdown of this “3C’s” framework is featured below.

Competition: Privatisation and deregulation during the 1980s and 1990s have determined increased competition among a previously protected market which has historically advantaged flag carriers. BA, Lufthansa, and AF, among other flag carriers, perceived the increasingly deregulated markets and privatisation as an ultimatum for performing more efficiently to survive incoming entrants. This study shows that all three flag carriers and indeed others in the industry perceived the European liberalisation packages of the late 1980s and early 1990s as an ultimatum for improving their operational efficiency to survive new entrants and increased competition. For example, this study highlights how BA was the earliest of the three flag carriers to pay close attention to the impending deregulation of the European market during the late 1980s within the context of its full privatisation. As a result of these pressures, BA developed new strategies for surviving competition, including adopting the scale strategy. These aspects are explored in subsequent chapters.

Cooperation: Cooperation through cross-airline investments and code-sharing has resulted due to this competition. Route linkages have been the aim of this cooperation. Consolidation through alliances, including Star Alliance, and mergers like the 2004 AF-KLM deal has resulted because of greater cooperation, where the goal has been network linkages. Nonetheless, competition continues to exist among alliances and mergers with new airlines joining and leaving these regularly. This intense cooperation between airlines is industry specific and highlights the network-type characteristics of the sector, or the reliance on network linkages to operate.

Consolidation: Intense cooperation leads to a cycle which ultimately favours consolidation. The framework returns to **Competition** as the alliances continue their pursuit of market share, although airlines also continue to join and leave these alliances. As noted throughout future chapters, these industry dynamics developments and the “3C’s” framework have been followed by all the major flag carriers. The aim of this perspective is to provide an analysis that goes beyond the firm level as a means of explaining wider developments within the industry, at the same time portraying a more nuanced overview of the industry where competition and cooperation go hand-in-hand.

The “3C’s” model is specifically applicable to the airline industry and explains the industry specificity of this sector for several reasons:

First, the model highlights the different stages of deregulation in this industry in an accessible and visual manner. The experiences of BA, Lufthansa, AF, and that of other major flag carriers inform the clear staging of events. The **Competition** (1^{st}) stage occurs during the late 1980s/early 1990s based on the liberalisation of the industry by means of route, tariff, and entry deregulation alongside the beginnings of airline privatisation. The model follows this with the **Cooperation** (2^{nd}) stage. The model shows that this second stage occurs as a result of the threat of increased **Competition** since the 1990s. To survive, flag carriers seek to form partnerships through cross-investments, takeovers, and code-sharing agreements. The model presents the **Consolidation** (3^{rd}) stage as the final event. Since the late 1990s, flag carriers further developed **Cooperation** by establishing the world’s largest alliances and mergers with the aim of building worldwide networks and concentrating market power. The “3C’s” model shows how these main stages occurred as well as the chronology behind them.

Second, the model uses the real experiences of BA, Lufthansa, AF and others in explaining industry developments. These experiences are specifically examined in detail in chapters 3, 4, and 5. In this sense, the “3C’s” framework is informed by the intra-firm strategies as a result of deregulation and privatisation. For example, BA, Lufthansa, AF, and other flag carriers embarked upon the scale strategy to withstand **Competition**. The scale strategy has involved **Cooperation** with other airlines to establish new routes, linkages, frequent flyer programmes, etc. eventually leading to **Consolidation**. Similarly, the self-disciplining of privatisation within the context of increased **Competition** led to the strategy of pursuing rationalisation ahead of flotation as a means of operational recovery and efficiency. In this sense, the intra-firm strategies and experiences of deregulation and privatisation by the major flag carriers are represented within this “3C’s” framework.

Last, the "3C's" model highlights other essential aspects of airline industry specificity. The framework shows the network type characteristics of this sector, which are especially important for understand developments. Throughout the **Cooperation** and **Consolidation** stages, flag carriers like BA, Lufthansa, AF, and others engage in network building where the end aim is the establishment of a worldwide network. Investments, takeovers, and code-sharing agreements led to closer cooperation and route linkages, while alliances and mergers expand these capabilities through closer cooperation and harmonisation of frequent flyer programmes. In this sense, no flag carrier can by itself effectively compete and survive in this industry while operating an extensive network without partnerships. At the same time, competition continues to exist between these flag carriers and alliances/mergers even in the context of pronounced market consolidation. As such, the "3C's" model also shows that cooperation and competition co-exist in this industry because of the network building characteristics displayed by flag carriers.

The main focus of the "3C's" model is to enhance the understanding of this industry. In this sense, the model has several implications for industry developments:

- The model shows that change in this industry has been consistent especially since 1980s deregulation. Developments continue in the form of industry re-orientation within alliances and mergers, with the aim of consolidating and acquiring market share.

- The model highlights **how** the industry has changed by presenting the stages of deregulation and **why** through the mechanisms of liberalisation, deregulation and privatisation.

- The model shows the causality behind the process of liberalisation, with the industry going through the stages of **Competition > Cooperation > Consolidation**. In this sense, the model shows a clear progression of liberalisation objectives within the civil aviation industry.

- The "3C's" model also presents these developments in a chronological manner based on the start of each deregulation stage. As such, the study notes how the flag carrier strategy develops over time at these various stages of deregulation and privatisation. It is noted that flag carriers generally pursued closer cooperative involvement with other airlines first through investments, takeovers, and code-sharing agreements during the late 1980s and throughout the 1990s. Since the late 1990s, these arrangements have been developed further into alliances and mergers.

- The flag carrier operational strategy has been developing to include more extensive route formations and linkages with partnered airlines than before, via the scale strategy. This has been the case for the industry as deregulation permitted route liberalisation, market entry, tariff setting, and alliance formation. The result has been the establishment of alliances and mergers prioritising the formation of a worldwide network between partners.

For the state-owned enterprise perspective, the study discusses the role of the state and its transformation over time from having a direct involvement in the flag carrier to assuming a more indirect custodian-type relationship for fully privatised flag carriers like BA and Lufthansa. For AF, the research notes a continued direct involvement of the state due to strategic and political reasons. Nonetheless, the study discusses how the state has historically intervened in all these cases to favour their flag carriers, through competition shielding, financial interventions, and most recently COVID-19 bailouts. The study also shows how the European Economic Community (EEC) and after 1993 the European Union (EU) supported this government-flag carrier relationship by approving state aid despite accusations of facilitating distorted competition. In this case, the study aims to portray the government-flag carrier relationship over time with reference to the main European airlines, a perspective which is absent from the state-owned enterprise and business history scholarship.

For the privatisation processes perspective, the research portrays airline restructuring, rationalisation, flotation planning, motivations behind the sale, change in employee status to share-holders, and the involvement of international consultancies to provide a detailed look at what goes on behind the sales and preparation. As the study shows, this approach goes beyond the traditional privatisation studies which are predominantly concerned with outcomes rather than processes.

The European case is considered for several reasons.

An overview of the European airline privatisation experiences with regards to the three main flag carriers, BA, Lufthansa, and AF, has not been provided to this date. As such, the information posed by these principal flag carriers in terms of how their privatisation experiences have shaped the sector in the long-run, the parties that have made airline privatisation possible, and how these and other airlines have developed over decades in the wake of deregulation represents a valuable source for scholarship and policy-making. As highlighted in this study, these three flag carriers have been at the forefront of industry changes, leading the airline privatisation developments and shaping the “3C’s” industry dynamics framework.

There has also been a European airline privatisation drive starting in the late 1980s and gaining more traction in the 1990s. These developments have still not been approached for research in an extensive manner to highlight longer-term developments at the carriers and the industry at large. Instead, case studies of individual airlines and country-specific research have taken precedence.

This introductory chapter provides a general background to privatisation as a policy-making instrument by explaining what it is, the rationale, ownership configurations, and the main drivers behind privatisation. Thereafter, the study provides an overview of airline industry characteristics, before considering several omissions in literature related to airlines and privatisation. The chapter concludes with the methodology section.

1.1 Concept and pre-history of privatisation

In its widely accepted and most common definition, privatisation refers to the transfer of ownership and responsibility of a business or concern from public to private hands. This should not be confused with deregulation, which means the relaxation of controls and regulation of a particular business or industry notwithstanding its ownership structure.[2] Hereafter, this definition is employed throughout the study when using the term.

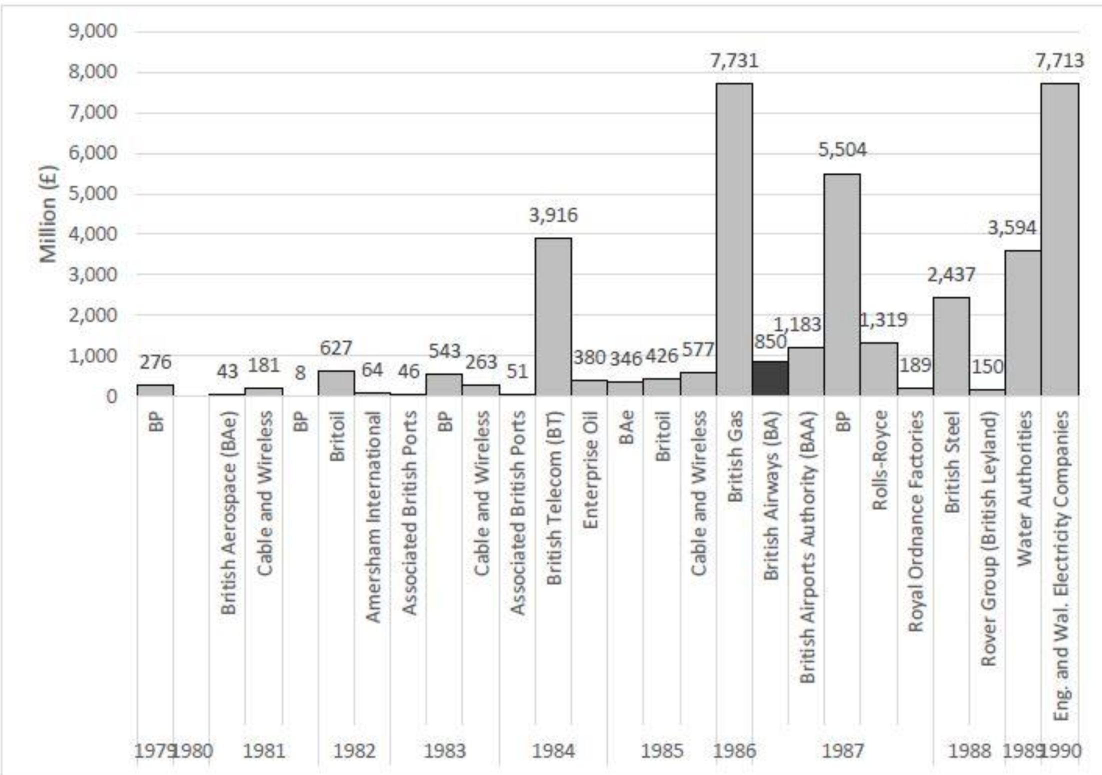
While scholarly attention is generally dedicated to the big deregulation push of the 1980s, privatisation itself was not new to that decade. The ideology of deregulated markets and focus on competition has been associated with the modern privatisation planning developed from the 1960-70s works of Friedrich von Hayek, Milton Friedman, and the Chicago School, which also passed on its influence across the world in countries such as Chile through its economists.[3] The Chilean economists at the time, termed the Chicago Boys, privatised social services and deregulated markets during the mid-1970s, symbolising one of the first international cases of privatisation outside of Western governments during that period. This influence extended to other parts of the world.

In the UK, there were a few cases of timid privatisation, such as that of road haulage in 1950s. Yet, these were functional sales rather than pronounced ideological shifts. Road

[2] For a concise definition of deregulation and privatisation applied on research within education, see Marianne Dovemark, Sonja Kosunen, Jaakko Kauko, Berglind Magnúsdóttir, Petteri Hansen, and Palle Rasmussen, “Deregulation, privatisation and marketisation of Nordic comprehensive education: social changes reflected in schooling”, *Education Inquiry*, 2018, Vol. 9, No. 1, pp. 122-41.
[3] Alejandro Carrasco and Helen Gunter, "The “private” in the privatisation of schools: the case of Chile", *Educational Review*, Vol. 71, January 2019, pp. 67-80.

haulage companies wanted to pursue more profitable routes than under nationalisation, staging vocal opposition to the government's aims. The 1972 Thomas Cook privatisation and the 1976 British Petroleum shares sale are other cases. It is true, however, that the Margaret Thatcher-led governments of the 1980s pursued privatisation with an unparalleled intensity. Thatcher put the theory of the Chicago School into practice by staging a radical programme of privatisation from 1979 to 1990, over the span of her three premierships (Figure 1.2). It is noteworthy that even BA, the UK flag carrier and one of the earliest major airline privatisations, was part of this programme. However, Thatcher was not alone in this endeavour. She had an ally and supporter in Ronald Reagan, the President of the United States, whose very own policies prioritised deregulation in the 1980s. In Western Europe, privatisation marked a significant departure from previous governments and their focus on the Keynesian orthodoxy of government intervention and increased regulatory oversight. The Thatcher-Reagan relationship and their similar views on deregulation and privatisation would come to shape world markets and future policy-making. Privatisation received the publicity it needed to be endorsed widely.

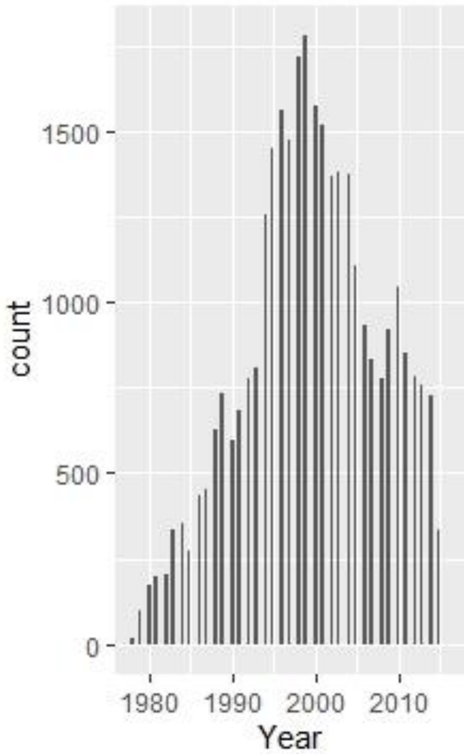
Figure 1.2 Annual breakdown of major Thatcher-period privatisations by net proceeds.[4]



[4] Reprinted from the author's own publication, Adrian Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it", *Business History*, 1 June 2021, pp. 1-20, Published online, Printed publication forthcoming.

Outside of national governments, international bodies, including the International Monetary Fund (IMF) and the World Bank also propagated the Washington Consensus, and its belief in the superiority of the free market, to developing countries in need of aid. Many of the structural adjustment programmes, or the conditions associated with a loan, have featured the privatisation and deregulation of key sectors. The IMF rising trend in privatisation conditionality is telling of how privatisation became a popular instrument for imparting free market ideals (Figure 1.3).

Figure 1.3 IMF privatisation conditions per year.[5]



The increasing endorsement of privatisation among international bodies along with international political developments such as the fall of Communism in Central and East Europe meant that more countries had the opportunity to embark upon or be lured into the laissez-faire promise after the 1990s. Romania is one representative case. Romania remains one of the countries with the most privatisation conditions imposed by the IMF in history, with privatisation programmes being undertaken on a wide scale across its telecommunication, petroleum, and energy industries.[6] Other Central and East European countries have encountered similar privatisation conditions, often matching the intensity of Romania's privatisation experience. These include its geographical neighbours Ukraine,

[5] The author's own representation, plotted in the R programming language, based on the IMF Monitor dataset from Alexander E. Kentikelenis, Thomas H. Stubbs, and Lawrence P. King, "IMF conditionality and development policy space, 1985-2014", *Review of International Political Economy*, Vol. 23, July 2016, pp. 543-82.

[6] Kentikelenis, Stubbs, and King, "IMF conditionality and development policy space, 1985-2014".

Serbia, and Moldova. Privatisation became more popular across the world. Indeed, very few countries, businesses, industries, and markets have escaped the influence of privatisation.

While there is much more to say about general privatisation and its extensive reach, the focus of this study lies elsewhere.[7] For that matter, the study now turns the attention to the rationale behind pursuing privatisation.

1.2 Privatisation rationale

The most important question which sits, or should be present, in any government's decision to privatise a business or industry is '*Why?*'. Why should a government decide to privatise? What is privatisation supposed to do? These are the central questions which stand at the foundation of policy-making. The answers to these are varied and depend on the rationale and motives behind the privatisation, although scholarship has been apt at identifying several recurring motives over decades of privatisation cases. It is important to note that these motives are not exclusive to specific businesses or industries, while the rationale to privatise may include multiple motives. An example is BA. As presented in Chapter 3, BA was originally prepared for privatisation with the aim to improve its productive performance. Once the airline's operating finances and efficiency improved, that motive was superseded by extending wider share-ownership through a successful Initial Public Offering (IPO) flotation.[8] This study notes similar and different rationales with Lufthansa and AF.

The following are some of the most common or popular motives behind privatisations along with their related theory:

1. **Improving Performance**—This motive is perhaps the most common of all given the amount of attention it receives from scholarship, which positions it at the forefront of privatisation motives.[9] Privatisation scholarship and neoclassical

[7] For studies related to the British experience of privatisation, see David Parker, *The Official History of Privatisation, Volume 1: The Formative Years 1970-1987* (London: Routledge, 2009); David Parker, *The Official History of Privatisation, Volume 2: Popular Capitalism, 1987-1997* (London: Routledge, 2012); for an assessment of privatisation in developing countries, see Saul Estrin and Adeline Pelletier, "Privatization in Developing Countries: What Are the Lessons of Recent Experience?", *World Bank Research Observer*, Vol. 33, February 2018, pp. 65-102; for the Russian experience of privatisation, see Stefan Hedlund, "Property Without Rights: Dimensions of Russian Privatisation", *Europe-Asia Studies*, Vol. 53, March 2001, pp. 213-37.
[8] Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it".
[9] For an assessment of how ownership transfer alone without other incentives may not be conducive to performance improvements, see Michael Beesley and Stephen Littlechild, "Privatisation: Principles, Problems and Priorities" [1983], In *Privatisation and Regulation: The UK Experience*, John Kay, Colin Mayer, and David Thompson (eds.) (Oxford: Clarendon Press, 1986), pp. 35-58; for an aggregate study of privatisation performance across sectors, see William L. Megginson, "Privatization, State Capitalism, and State Ownership of Business in the 21st Century", *Foundations and Trends in Finance*, Vol. 11, November 2017, pp. 1-153; Juliet D'Souza and William L. Megginson, "The Financial and Operating Performance of Privatized Firms during the 1990s", *The Journal of Finance*, Vol. 54, 1999, pp. 1397-1438. It is evident that most of the studies cited in these works prioritise performance-related research over other privatisation motives or processes.

economic theory argue that a newly-privatised business will be incentivised to perform better as it reorients its aims as a consequence of responsibility transfer from the government to the new owners.[10] While the extent upon which ownership transfer is solely responsible for developments rather than other contextual incentives, such as regulatory overwatch and competitive pressures from market competitors continues to be a debated topic, evidence nonetheless finds that businesses have historically performed better after privatisation.[11] It is noteworthy that this research has mainly been directed toward public utilities performance, while some sectors including airlines, remain open to more research for understanding privatisation processes and outcomes. This case is discussed below when the study explores existing research on the topic.

2. **Fostering Competition**—Competition is associated with improving performance and relates to the above point. The pressure of current and new entrants to the market as well as the assumed impartiality of the government (i.e. the lack of a safety-net to save the business from failing) related to the newly privatised business are some of the main aspects which underpin the economic theory behind competition and privatisation. These competitive incentives would lead the business to perform more efficiently by driving down costs and renouncing unprofitable services. The scholarship is currently clearer about competitive rather than ownership effects.[12] While this is not the subject of the study's discussion given the focus on processes, it is important to note that disentangling the effects of ownership transfer from those of competitive pressures is often difficult given context and diverse ownership structures.

3. **Reducing or Expunging Borrowing from the Government**—While under state control, the business may likely depend on government finances and subsidies to operate, especially in cases of financial loses and inability to self-finance. When the burden on public finances becomes evident or the state-owned

[10] John Vickers and George Yarrow, *Privatization: An Economic Analysis* (The MIT Press, 1988), pp. 7-45.

[11] See Megginson, "Privatization, State Capitalism, and State Ownership of Business in the 21st Century"; D'Souza and Megginson, "The Financial and Operating Performance of Privatized Firms during the 1990s".

[12] For an example from the airline industry of how competition rather than standalone privatisation may have had a more pronounced impact on performance, see Richard Green and Ingo Vogelsang, "British Airways: A Turn-Around Anticipating Privatization", in *Privatization and Economic Performance*, Matthew Bishop, John Kay, and Colin Mayer (eds.) (Oxford University Press, 1994), pp. 89-112; for a case study from the telecommunications sector related to the same subject, see Agustin Ros, "Does Ownership or Competition Matter? The Effects of Telecommunications Reform on Network Expansion and Efficiency", *Journal of Regulatory Economics*, Vol. 15, January 1999, pp. 65-92.

business frequently necessitates funding above its agreed threshold, privatisation can be considered to shift the financing responsibility to private owners. The government also receives a much-welcomed sale proceed through privatisation. The UK example is remarkable as the first Thatcher government (1979-83) introduced the Medium-Term Financial Strategy initiative to control borrowing by imposing ceilings or thresholds to its state-owned businesses. This was done with the hope that it would relieve inflation concerns given that public sector borrowing was considered the largest credit counterpart of the money supply, which in turn was associated with inflation.[13]

4. **Extending Wider Share-Ownership**—Unlike the previous motives, encouraging wider share-ownership can be perceived in more ideological rather than economic terms. Reagan affirmed: "Could there be any better answer to the stupidity of Karl Marx than millions of workers sharing in the ownership of the means of production?”.[14] His view was shared by British policy-makers in the 1980s. Seeing this as an attractive vehicle for electoral support, Thatcher-government advisers embraced the relative simplicity and universality of the cause:

   > Many find it difficult to grasp…economic concepts but would have little difficulty…with the concept of ownership—it is something that people can understand, believe in, and vote for.[15]

   The development of a culture of shareholders can be instilled among the general population if the sale is structured in such a way as to make individual owners take part within wealth formation and accumulation. In some situations, this potentially means sacrificing sale proceeds. Popular mechanisms include deliberate share under-pricing, incentives for share retention, and limits imposed on institutional shareholding, among other.[16] In the UK, extending share-

[13] Geoffrey Howe, *Conflict of Loyalty* (London: Macmillan, 1994), p. 254.
[14] Ronald Reagan, quoted in *Employee Ownership, Participation and Governance: A study of ESOPs in the UK*, by Andrew Pendleton (London: Routledge, 2001), p. 5.
[15] Nigel Vinson, Centre for Policy Studies, letter to Margaret Thatcher, 11 June 1981, THCR 2/11/3/1 Part 2, (Cambridge, Churchill College Archives, University of Cambridge, 1981).
[16] For the various mechanisms for extending privatisation share ownership, see Bruno Biais and Enrico Perotti, "Machiavellian Privatization", *The American Economic Review*, Vol. 92, March 2002, pp. 240-58; Enrico Perotti, "Credible Privatization", *The American Economic Review*, Vol. 85, 1995, pp. 847-59; Maxim Boycko, Andrei Shleifer, and Robert Vishny, "Voucher privatization", *Journal of Financial Economics*, Vol. 35, April 1994, pp. 249-66.

ownership to the general public was termed “popular capitalism”. While the proportion of shareowners increased from 7% in 1979 to 25% by the time of Thatcher’s resignation, shares were often concentrated within organisations rather than individuals.[17]

1.3 Ownership configurations

Beyond the rationale of privatising, the government has several options, or configurations, available when deciding how to structure the ownership of the business and its sale. This is important to acknowledge at this stage as the airlines examined in the study fall within said structures, but also because of the potential differences that can be discerned depending on ownership in terms of operation when discussing the processes behind flotation. Generally, these ownership structures are grouped in four categories depending on how much private shareholding exists within the business after privatisation:

1. **Minority Private Ownership**—The government continues to retain the majority of the shares within the business after privatisation, while private shareholders may own less than 50% of the company. One such example from the airline industry is Finland’s flag carrier Finnair, which is 60% currently owned by the government, while the rest belongs to private groups.[18]

2. **Mixed Ownership**—The government and private shareholders both own half of the company after privatisation. This configuration is exemplified by the ownership structure at TAP Portugal before the COVID-19 bailout, which was half-owned by the Portuguese government, while the other half was retained by private investors.[19]

3. **Majority Private Ownership**—The government owns less than the private shareholders, which represents less than 50% of the company after privatisation. This is true for the Air France-KLM merger which is majority owned by private shareholders, while the governments of France and Netherlands own nearly 40%

[17] Howe, *Conflict of Loyalty*, p. 257; Nigel Lawson, *1988 Budget*, 15 March 1988, Hansard, UK House of Commons, Vol. 129, cc. 993-1013.
[18] Finnair, "Shareholder structure", Retrieved from: https://investors.finnair.com/en/shareholders/shareholder-structure [Accessed on 16 January 2023].
[19] Reuters, *Portugal seals final deal with TAP's private shareholders*, 3 July 2020. The COVID-19 bailout increased the stake of the government to 72.5% ownership of TAP. However, as of December 2022, the government is considering selling back the shares and re-privatising the company.

of the merger combined (28.6% belongs to the French government, 9.3% to the Dutch state).[20]

4. **Full Private Ownership**—The private shareholders own 100% of the business after privatisation, whereas the government does no longer hold a stake in the company. The BA privatisation provides an example for this configuration. The airline was fully privatised in 1987, with private investors holding 100% of BA ownership.

There have been studies that have attempted to assess which of these configurations yield the most improvements in financial and productive performance in a variety of sectors and case studies. These reveal that privately-owned businesses have generally performed better than their state-owned counterparts.[21] For airlines, Backx et al. employ regression analysis to suggest that majority or fully-private private ownership airlines generally perform better than mixed ownership, while publicly-owned airlines are the worst performers in terms of profits, employee productivity, among other variables.[22] As such, the study comes to similar conclusions to the research on the ownership of other industries. However, the authors admit that performance outcomes may be influenced by geographical region, airline size, routes, and other factors, making context especially important when researching a larger sample.

1.4 An overview of airline industry characteristics

As this study highlights in future chapters, the airline industry exhibits several main important characteristics. For the purpose of providing context and for a better understanding of industry specificity, the focus here is directed at industry organisation and socio-technical systems.

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[20] Air France-KLM, *Shareholding Structure*, as of 31 December 2022, Retrieved from: https://www.airfranceklm.com/en/finance/financial-information/capital-structure [Accessed on 16 January 2023].

[21] For a detailed analysis of privatisation scholarship which includes ownership outcomes, see William L. Megginson and Jeffry Netter, "From State to Market: A Survey of Empirical Studies on Privatization", *Journal of Economic Literature*, Vol. 39, 2001, pp. 321-89; for a case study of privatisation ownership outcomes in Asia, see Sumit Majumdar, "Assessing comparative efficiency of the state-owned mixed and private sectors in Indian industry", *Public Choice*, Vol. 96, 1998, pp. 1-24; for an example of privatisation ownership outcomes from Central Europe, see Roman Frydman, Cheryl Gray, Marek Hessel, and Andrzej Rapaczynski, "When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies", *The Quarterly Journal of Economics*, Vol. 114, November 1999, pp. 1153-1191.

[22] Mattijs Backx, Michael Carney, and Eric Gedajlovic, "Public, private and mixed ownership and the performance of international airlines", *Journal of Air Transport Management*, Vol. 8, July 2002, pp. 213-20.

1.4.1 Industry organisation and specificity

The following aspects represent the way this industry has been organised and its specificity:

First, the airline industry was highly regulated before 1980. This meant that market entry was limited to mainly national flag carriers within the domestic setting. For the international markets, bilateral agreements were in effect. These were negotiated between governments and only flag carriers were allowed to operate on specific routes. Tariffs were also fixed and pre-approved through the International Air Transport Association (IATA). In this sense, competition was highly curtailed, and the presence of non-flag carriers was restricted (e.g. low-cost carriers would appear later and only in the context of pronounced liberalisation in the sector).[23]

Gradual liberalisation occurred after the 1980s within the European setting. Starting in the late 1980s, the EEC introduced a series of liberalisation packages, which culminated with the formation of the Single Aviation Market by 1997. Importantly, market entry was relaxed, tariff setting was devolved to the airlines, and increased international competition from flag and non-flag carriers became a reality.[24] Competition and the crises resulted from cyclical events, such as the First Gulf War, determined the need for cooperation through airline partnerships, investments, and take overs (e.g. BA taking over BCal in 1988, its domestic competitor, AF taking over its domestic competitors UTA and Air Inter in the 1990s). The main aim of this cooperation was to become large enough to survive and operate effectively. The study terms this the scale strategy.

More pronounced cooperation has led to the formation of alliances, including the largest three: Star Alliance, Oneworld, and SkyTeam, which account for half of the market share in terms of passenger revenue.[25] Within Europe, the 2004 AF-KLM merger and the resulting responses from the BA and Iberia as well as the Lufthansa Group mergers signalled pronounced European market concentration. Alliances and mergers have led to the consolidation of the international airline market. These developments are exemplified by the "3C's" industry framework presented in this study, which represents industry specificity.

Second, new privatisation processes emerged along with the beginnings of airline privatisation within the sector. Rationalisation processes of cost-cutting and service reorientation ahead of flotation became a tool for recovery and eventually an industry

[23] William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition, pp. 9-10.

[24] Peter Belobaba and Amedeo Odoni, "Introduction and Overview", in *The Global Airline Industry*, Peter Belobaba, Amedeo Odoni, and Cynthia Barnhart (eds.) (Chichester: John Wiley & Sons, 2009), pp. 1-17.

[25] Keith Debagge and Khaula Alkaabi, "Market Power and Vertical (Dis)integration? Airline Networks and Destination Development in the United States and Dubai", in *Aviation and Tourism: Implications for Leisure Travel*, Anne Graham, Andreas Papatheodorou, and Peter Forsyth (eds.) (Surrey: Ashgate Publishing, 2010), p. 156.

standard. The example of the BA early 1980s rationalisation programme represented a template for future airline privatisations, including Lufthansa and AF. These followed in similar rationalisation steps, aiming for a quick recovery ahead of flotation. This is discussed in subsequent chapters. Consultancies have also used their experience in privatisation planning to propagate the IPO model of flotation within the airline sector, alongside strategies of stimulating demand for the sale by offering discounted shares and favourable employee benefits. As part of privatisation, the status of airline employees has also changed from civil servants to employees and shareholders as the majority bought shares at BA, Lufthansa, and AF. In these situations, the privatisation process has further contributed to the industry dynamics of this sector. These privatisation processes are discussed throughout the study.

Third, European governments were directly involved in the operations of their flag carriers before 1980. The state negotiated bilateral agreements, decided on fleet purchasing policy (e.g. BA and the "Buy British" policy, Lufthansa and Airbus, etc.), curtailed airline investments and borrowings, and appointed managers, etc. Since privatisation and deregulation in the European sector, the role of the state has assumed a role akin to a custodian. In this new role, the state acts indirectly (in the situations where the state has already divested from its flag carrier) to support the flag carrier. This flag carrier favouritism exists and is most recently highlighted through the COVID-19 bailouts. For example, BA has enjoyed state-backed loans, whereas Lufthansa and AF have benefited from a more direct form of government intervention where a minority share ownership has been re-acquired. Nonetheless, this study highlights how flag carrier favouritism manifested before the COVID-19 bailouts. Examples featured in the study include the BA 1980s government licensing deals, the German government resolving and essentially covering the expenses of Lufthansa related to its early 1990s pension problems, and the early 1990s AF government bailout. The relationship between flag carrier and government continues in this different context of deregulation, although it also brings about concerns of distorted competition between flag carriers and non-flag carriers. These aspects are discussed in future chapters.

Fourth, the airline industry is also a network-type industry where network building is essential to the operations of the flag carriers. This represents industry specificity. In this sense, the flag carriers presented in this study operate a hub-and-spoke network where the hub lies at the centre of operations. From this hub, for example London Heathrow in the BA case, the airline connects to other airport destinations or spokes. The main aim of the hub-and-spoke network is the maximisation of feasible connections for incoming passengers.[26] For each additional spoke or destination it operates, the airline integrates this destination with its main hub for better network connectivity and linkage benefits for passengers. This study discusses the hub-and-spoke network system by considering the importance of hubs towards the flag carrier's operations. Secondary hubs are also discussed as part of the scale strategy. As this study portrays, the network-type characteristics of this industry are reflected within the **cooperation** and **consolidation** phases of the "3C's" framework by means of partnerships and alliances. It is important to acknowledge that there are also other types of networks in the airline industry. For example, European LCCs focus on operating a linear-type network prioritising point-to-point services. These are also called origin to destination services, where building a hub-and-spoke network is not prioritised. Instead, point-to-point services are aimed at exploiting the economies of density available between major destinations and maintaining reduced operating costs via no frills services. In this sense, there is a limited integration of operations, which contrasts with the hub-and-spoke network of the flag carriers. This point-to-point linear system is discussed in Chapter 3 related to LCCs and how these differ from flag carriers in terms of the scale strategy.

Fifth, the airline industry is a cyclical industry. This means that demand is highly dependent on business cycles and worldwide crises. This is why flag carriers have encountered downturns every time a large crisis like the First Gulf War, 9/11, or the Chernobyl disaster depressed international traffic. High oil prices and oil supply fluctuations have also been damaging to the industry. To offset the oil prices, flag carriers have invested in the adoption of more fuel-efficient aircraft. This study highlights the cyclical nature of this industry throughout future chapters, although also discusses how governments have aided flag carriers like AF survive these crises. This flag carrier sensitivity to business cycles also explains the industry specificity of the "too big to fail" scenario, where governments intervene to aid the civil aviation transport infrastructure. The rationalization planning for recovery as a response to these crises is also discussed.

Last, technological progress must be acknowledged. While not specifically examined in detail in this study, technological progress in terms of aircraft capacity, fuel efficiency, and range have contributed to developments in operational performance, efficiency, and the possibility of expanding operations across the world (e.g. the Boeing 747 and its dominance of transatlantic operations).[27] In this study, fleet developments are discussed related to the

[26] Stephen Holloway, *Straight and Level: Practical Airline Economics* (Aldershot: Ashgate, 1997), pp. 251-61.
[27] William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition, pp. 7-8.

rationalisation and scale strategy. The technological aspect is expanded upon within the following section where aircraft manufacturers are discussed as socio-technical participants.

1.4.2 Socio-Technical systems

In this sub-section, airports, aircraft manufacturers, and consultants are discussed as a means of providing context to the civil aviation socio-technical systems. Socio-technical systems comprise elements and participants of an industry or business, which taken together form the industry specificity. There are many different systems and participants involved in the civil aviation industry. For the purpose of providing a concise overview of these, the study discusses participants that are developed in chapters 3, 4, and 5 with specific reference to the cases of BA, Lufthansa, and AF. LCCs, air cargo, and the air charter businesses are discussed as business models and industry participants in Chapter 2, where the study provides an overview of the contours of this industry.

1.4.2.1 Airports

Airports are essentially the gateways for travel and connection of flight services. As part of the described hub and spoke model of flag carrier operations, airports represent the centre of airline operations. Global hubs like Heathrow, for example, act as the main strategic hub of operations for BA from which the flag carrier builds its network. In this sense, airports and connections from and to other airports are essential for sustaining the network-type characteristics of this industry. As shown in chapters 3, 4, and 5, BA, Lufthansa, and AF also developed secondary hubs for strategic network building at locations like Gatwick, Munich, and Paris Orly. These secondary hubs focused on establishing domestic services, but also acted as links to the main hubs for further international travel. For BA, Lufthansa, and AF, their main hubs at Heathrow, Frankfurt, and Paris Charles de Gaulle have been especially important toward developing transatlantic operations during the 1980-1990s.

LCCs like Ryanair and Wizz Air also develop hubs. However, these are predominantly based at smaller secondary airports which are often adjacent to major cities for cost and airport charges reasons, but also due to the point-to-point model they operate where network building is not as entrenched compared to flag carriers. For example, airports like London Luton and Stanstead have become hubs for LCCs like Ryanair and easyJet.

Importantly, airports offer services like check-in, luggage handling, additional transportation, etc. involving many other support networks and socio-technical participants. In this sense, airports provide important international and regional economic benefits. These lead to other positive externalities where businesses like aircraft maintenance, catering companies, and the headquarters of flag carriers, among other participants are attracted to the local economy creating business clusters.

Like flag carriers, airports have been under government ownership before the 1980-1990s due to their strategic and economic importance.[28] As such, governments have invested in developing the airport infrastructure and surrounding linkages by developing new airport terminals, expanding runways, and allocating more departure and landing slots, among other developments. Since the 1990s, major airports and operators were also privatised, including the British Airports Authority, Dusseldorf, Rome, Paris, etc.[29] Similar to the reasons for flag carrier privatisation, airports have been privatised on motives related to improving operational efficiency, raising capital, improving service quality, and infrastructure development, among other reasons. By 2017, 51% of the top 100 busiest airports for passenger traffic had private sector involvement to some extent.[30] This highlights that deregulation and privatisation have also expanded within the airport industry. The major choice of sale for these has also been the IPO flotation. However, there have been more trade sales or long leases to a consortium of investors in the past decade. Under these lease agreements, the government still retains ownership of the airport but transfers management to the private sector for several years. The aim here is the strategic ownership of the airport given its infrastructure and economic importance. Airports that include this type of agreement include Lyon, Rome, Milan, and Sydney.[31] As such, privatisation in the airport industry also has its limitations due to ongoing government presence.

The relationship between airports and airlines is also noteworthy. Both co-exist to provide services to customers, to establish linkages, and to provide regional support. For example, the efficiency of airport ground crew is essential to the operating times of the airline. Gate checks and time, baggage handling, ground transportation, security, etc. are some of the most important aspects of providing service quality. This is why airlines and the government intervene to develop the airport infrastructure. In Chapter 3 on BA, the study highlights how the UK government and BA developed fast-track channels at Heathrow and Gatwick starting 1994-95 for faster passenger access through immigration and customs. Starting 1993, BA expanded support businesses close to airports for faster maintenance times. BA opened an in-house avionic engineering facility for aircraft maintenance, repairs, and components changes in Glamorgan, South Wales. Other similar maintenance support facilities were later opened near Cardiff and Glasgow airports.

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[28] Anne Graham, "Airport privatisation: A successful journey?", *Journal of Air Transport Management*, Volume 89, 19 September 2020.
[29] Graham, "Airport privatisation: A successful journey?", *Journal of Air Transport Management*, Volume 89.
[30] Graham, "Airport privatisation: A successful journey?", *Journal of Air Transport Management*, Volume 89.
[31] Graham, "Airport privatisation: A successful journey?", *Journal of Air Transport Management*, Volume 89.

Another example comes from the Munich airport and its relationship with Lufthansa. In 2003, a new terminal was opened at Munich airport with the financial backing of Lufthansa. This was a first of its kind event in Germany where an airline was directly involved in these costs.[32] Nonetheless, the new terminal was built with the aim of housing Lufthansa and Star Alliance members operations. In this sense, the airline and its partners benefit from this arrangement, having their operations integrated better at the hub. The airport also benefits by having reduced financial expenditure and responsibility for the new terminal as costs and planning is shared with Lufthansa.

In this sense, the airport also becomes a hub for the airline as it provides regional support services to match increasing operational demands, while the airline becomes a customer to the airport due to the airline's presence and involvement in expanding the services at the airport.

1.4.2.2 Aircraft manufacturers

Aircraft manufacturers are the suppliers of fleets for the flag carriers. In this case the relationship with airlines is that of customer-supplier. Aircraft manufacturers like Airbus, Boeing, McDonnell Douglas, the British Aircraft Corporation (BAC), among others, have supplied the civil aviation industry throughout the post-war period. Nonetheless, two major suppliers have taken over the majority of the civil aviation suppliers market share since the late 1980s. These are Airbus and Boeing. The duopoly has supplied flag carriers like BA, Lufthansa, AF, and most of the market with various aircraft models with different technical capabilities.

For example, the Boeing 747 and the Airbus A320 became industry-wide adopted aircraft models due to their fuel efficiency, ease of operation, capacity, and manufacturer support. The 747 was used extensively on the profitable transatlantic services of the 1980s and on long-haul services until it was supplanted by more fuel-efficient twin-engine wide-body aircraft. Similarly, the narrow-body A320 has been used as the preferred choice for short to medium-haul services, usually on intra-continental routes, due to its fuel efficiency, cost, and capacity. The A320 continues to be used to this day due to these characteristics. In this sense, flag carriers and other airlines have informed the demand for specific aircraft types like the A320 based on the strategy and route building of the airline.

For example, LCCs tend to favour fleet homogenisation and narrow-body aircraft, like the Airbus A320 due to cost and their operational model of short to medium-haul

[32] Sascha Albers, Benjamin Koch, and Christine Ruff, "Strategic alliances between airlines and airports—theoretical assessment and practical evidence", *Journal of Air Transport Management*, Volume 11, Issue 2, March 2005, pp. 49-58.

services. However, flag carriers and their hub and spoke model operate short, medium, and long-haul services. This means that flag carriers will have a fleet comprising a mix of aircraft models, including the narrow-body and short-haul A320 as well as the wide-body and long-range Boeing 787 Dreamliner to service these functions. For example, chapters 3 and 4 on BA and Lufthansa, respectively, highlight the late 1980s-early 1990s fleet compositions of the two flag carriers. Here, the study shows that different models from different aircraft manufacturers, including Boeing, Airbus, and BAC, were used in operation.

In terms of aircraft technology, all airlines and aircraft manufacturers have chased fuel efficiency. This is why aircraft manufacturers have transitioned from the more fuel-inefficient four-engine Boeing 747 to more fuel-efficient twin-engines over time. As engines became more powerful for transatlantic routes and maintenance costs increased, the four-engine aircraft became economically difficult to justify. The more recent failure of the Airbus A380 four-engine aircraft exemplifies this. The A380 was launched in 2007. However, the financial crisis, the high fuel prices, and the expensive costs of purchasing and operating the aircraft contributed to its low demand. In fact, the industry was already moving to smaller and more fuel-efficient twin-engine aircraft like the Boeing 787 and 777X.

Because of the aircraft manufacturer mix at flag carriers, governments and other public participants are also involved due to strategic production reasons. For example, Airbus was established by government initiatives from Germany, France, and the UK in 1967. Boeing is a U.S. manufacturer also contracted with the domestic military. As such, tensions occurred between flag carriers and the government over fleet acquisition policy. This has been especially true under nationalised flag carriers. This is discussed in chapters 3 and 4 on BA and Lufthansa. For example, the post-war “Buy British” policy of the UK government created tensions between BA and the government as the fleet acquisition policy was often made under strategic rather than economic considerations. During the early 1970s, the UK government determined BA to acquire the British-made Vickers VC10 and the BAC One-Eleven over the more fuel-efficient Boeing 737. Furthermore, there was another strategic dimension to this. Rolls-Royce produced aircraft engines which were fitted in European aircraft. In comparison, the Boeing 747 originally came fitted with the American-made Pratt and Whitney engines. However, the wider adoption of the 747 and its advantageous characteristics could not be neglected. This is why BA and the government funded new 747 orders in the late 1970s that specifically came with Rolls-Royce engines.[33] In this sense, the “Buy British” policy subsided over time as aircraft manufacturers

[33] Hansard, *British Airways' Future Strategy*.

themselves offered different aircraft engine options and configurations to please their customers.

In the Lufthansa example present in Chapter 4, the study shows how privatisation and the change in ownership to private hands was perceived as a potential threat toward the Lufthansa fleet acquisition policy. In the early 1980s, German politicians from the Christian Social Union in Bavaria and their leader, Franz Josef Strauss, argued that a privatised Lufthansa would harm Bavarian state interests by no longer supporting the local aerospace manufacturing industry and its jobs. This may have occurred if Lufthansa favoured procuring Boeing aircraft over Airbus. The Bavarian aerospace manufacturer Messerschmitt-Bölkow-Blohm was involved with the Airbus consortium in producing the A300 aircraft, the world's first twin-engine wide-body aircraft.[34] However, opposition to privatisation subsided as Lufthansa continued to operate a mix of Airbus and Boeing aircraft depending on route needs.

Nonetheless, international tensions on the strategic government aid of aircraft manufacturers continued to persist. Starting 2004-05, both the EU and the U.S. filed cases against each other at the World Trade Organization on grounds of subsidising Airbus and Boeing, respectively. In 2019-20, the U.S. and EU imposed tariffs on each other after the World Trade Organization arbitrators awarded the U.S. and EU the right to impose tariffs on each other.[35] The U.S. imposed a 15% tariff on imported Airbus aircraft to the U.S. markets as well as various smaller tariffs on imported aircraft parts from the EU. These U.S. tariffs totalled over $7.5 billion on European products, while EU responded with tariffs worth over $4 billion on U.S. products due to Boeing subsidies.[36] In 2021, the dispute was resolved due to years of disputes, the COVID-19 pandemic, and losses on both sides due to the tariffs. As part of the new deal, the U.S. and EU agreed to suspend the tariffs and provide more transparency to the research and development funding for Airbus and Boeing. It was also agreed not to provide any tax breaks for the aircraft manufacturers that could disadvantage competitors.[37]

The above experiences highlight the strategic importance of aircraft manufacturers to the economy, to flag carriers, and not least to governments. Over time, there have been situations where tensions occurred over the use of aircraft manufacturers due to the involvement of governments, as this study shows with the BA and Lufthansa examples. The more recent experiences with the U.S.-EU tariff war exemplify that these tensions have not

[34] Franz Josef Strauss, CSU Chairman, interview with Flugbegleiter newspaper, December 1984, B126/143239; Strauss, interview with Frankfurter Allgemeine newspaper, 15 December 1984, B126/143239.
[35] European Commission press release, *EU and US take decisive step to end aircraft dispute*, 15 June 2021.
[36] Reuters, *Highlights of the 17-year Airbus, Boeing trade war*, 16 June 2021.
[37] Reuters, *Highlights of the 17-year Airbus, Boeing trade war*.

yet been bypassed completely despite privatisation and deregulation within the civil aviation industry.

1.4.2.3 Air service providers

The civil aviation industry relies on many support networks and businesses. In the majority of cases, flag carriers and airports delegate sensitive roles such as ground handling, fuelling, catering, as well as air cargo services to independent contractors. International Businesses like Menzies Aviation and Dnata, as well as more local providers like German Aviation Service (GAS), have created partnerships with leading flag carriers and airports. Recently, the largest participants in providing air services have also joined partnerships with IATA. In this sense, these participants receive official recognition from the main civil aviation regulatory body for their services.

For ground handling services, these participants deal with baggage handling, check-in of passengers, aircraft de-icing procedures, cabin cleaning, and premium lounge management, among other support services.

For fuelling procedures, these independent companies are in charge of safely storing, managing, and delivering fuel to the aircraft, as well as providing defuelling. For this, they own, lease, and operate equipment like fuelling tanker trucks. They also have to abide by IATA fuelling standards in terms of safely handling and fuelling the aircraft.

For air cargo services, air service providers handle the management and transportation of luggage cargo, sensitive cargo, including live animals and dangerous goods, but also work alongside air freight carriers by providing loading, unloading, and various ramp handling services. As part of these ramp handling services, the providers interact and work with other logistics companies, such as FedEx and DHL for ground transportation of cargo and access to storage facilities.

Because of their widespread direct involvement in the running of airport and flag carrier-associated services, these air service providers represent an essential part of the socio-technical system. This is why airports and flag carriers have signed agreements and licenses to delegate additional support services to providers. For example, Menzies Aviation has expanded its operations across the globe, striking licensing agreements with airports from South America, including Mexico, Colombia, Costa Rica, etc. in 2023.[38]

As their influence grows within the civil aviation industry, the providers also look to acquire other ground handling businesses and local providers as means of expanding to new

[38] Menzies Aviation press release, *Menzies Aviation continues Latin America expansion with new operations in Costa Rica and Chile*, 24 March 2023.

markets. In 2023, Menzies Aviation entered the Bulgarian air cargo market by acquiring a majority stake in the regional Cargo Handling Services Limited provider at Sofia International Airport.[39] This means that Menzies will now provide a range of cargo services at Sofia airport, including warehousing, import and export handling, mail handling and storage for more than 21 airlines which are currently operating at the airport. The main aim for these aviation service providers is the expansion to as many airlines and airports as possible.

1.5 Literature review

In this section, the study considers how literature has acknowledged and researched airlines, privatisation, industry dynamics, and state-owned enterprises over time. For the purpose of the study and by means of utilising research categories, this is addressed with reference to the industry dynamics, state-owned enterprises, and privatisation processes perspectives introduced above. The section also includes an overview of alternative theoretical approaches, including the Varieties of Capitalism literature. While these alternative approaches do not make the focus of this study, they nonetheless help contextualise and frame the discussions surrounding the privatisation cases.

1.5.1 Industry dynamics

Scholarship on industry dynamics is vast, yet rarely considers the airline industry and the connections between intra-firm airline strategy and the development of the industry. Temporality, or the attention to developments over time, is often neglected in this type of scholarship. The attention has been primarily dedicated to specific points in time by employing a focal lens. The research of Chandler, while ground-breaking, is mainly focused on a firm-centric approach to explain the creation of the industrial firm.[40] This approach encompasses what Chandler calls the "collective histories" of the largest U.S. companies, although without engaging with the airline industry.[41] Nonetheless, by virtue of its focus, industry-wide developments are often overlooked, bundled-up with other industries, or not thoroughly differentiated. Other similar firm-centric studies, although with a more recent focus on the airline industry, come from Fauri, Dienel and Lyth, and Cozmuta.[42]

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[39] Menzies Aviation press release, *Menzies Aviation enters the Bulgarian air cargo market*, 18 July 2023.
[40] Alfred Chandler Jr., *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, MA: Belknap Press, 1990).
[41] Chandler Jr., *Scale and Scope*, p. 11.
[42] Francesca Fauri, "The Italian State's Active Support for the Aeronautical Industry: The Case of the Caproni Group, 1910-1951", *Business History Review*, Vol. 95, No. 2, Summer 2021, pp. 219-247; Adrian Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it", *Business*

A similar focal approach is distinguished, although one that encompasses industry-wide dynamics, with other prolific authors, including Michael Porter. Porter explains the development and common elements of industry at large, with attention dedicated to the specifics of competition within the industry as a principal driving force behind changes.[43] Porter describes this as:

> An industry (whether a product or service) is a group of competitors producing products or services that compete directly with one another.[44]

Without detailing the example of the airline industry, Porter's analysis is nonetheless all-encompassing. However, its focus does not permit a more detailed assessment of industry specificity given the attention to what industry, in general terms, represents. In this sense, there is often a disconnect between intra-firm and industry-wide linkages given the focus on the macro level to best explain industry dynamics and developments in both Chandler and Porter's research.

The attention to temporality is also often neglected. Given their focal analysis of specific points in time, both studies avoid delving deeper into changes over time and under specific contexts. Indeed, this general lack of attention to temporality has been recently criticised by business historians. For example, in their review of industry emergence literature, Gustafsson et al. note:

> Dominantly, the current contributions to the emergence process stem from single-case studies that do not relate the contingencies between the focal case and its institutional, geographical or temporal context.[45]

This study goes beyond the Chandler and Porter type analyses by considering intra-firm strategy as well as how these have informed industry-wide dynamics, and vice versa. The present study also highlights changes through time and the importance of temporality to best understand how the industry has developed. The airline industry is particularly fruitful

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History, 1 June 2021, pp. 1-20, Published online, Printed publication forthcoming; Hans-Liudger Dienel and Peter Lyth (eds.), *Flying the Flag: European Commercial Air Transport since 1945* (Basingstoke: Palgrave, 1998). Dienel and Lyth's edited volume considers the overall stories of the main European flag carriers, including BA, Lufthansa, KLM, among others. However, these studies do not account for the similarities of scale strategy or privatisation planning between other main carriers as presented in this study.

[43] Michael Porter, *The Competitive Advantage of Nations* (Basingstoke: Palgrave, 1998).

[44] Porter, *The Competitive Advantage of Nations*, p. 33.

[45] Robin Gustafsson, Mikko Jääskeläinen, Markku Maula, and Juha Uotila, "Emergence of Industries: A Review and Future Directions", *International Journal of Management Reviews*, January 2016, Vol. 18, pp. 28-50.

for such an analysis given the "3C's" framework specifics, the pronounced changes through the decades, and the focus on airline privatisation processes. Unlike Chandler and Porter, the study highlights the industry specificity of the airline business, providing a more nuanced and fine-grained interpretation. The study shows how competition and cooperation are equally important via alliances and mergers, but also how intra-firm strategies of scale and consolidation deserve their spotlight to best understand industry dynamics.

In this sense, the study embraces the type of industry dynamics approaches proposed by and found in research by Stokes, Owen, Kurosawa, and Fear, among others.[46] While these works exemplify different industries, the analyses of the German chemical industry, the rise and demise of Courtaulds, and the Thyssen-Konzern alongside their internal strategies help explain the development of the larger chemical industry, UK textile industry, and that of German steel manufacturing, respectively. Here too, the study notes the important role of rivalry, cooperation, and international networks between firms. The role of international and cross-border cooperation by flag carriers through alliances, mergers, and international consultancies is also highlighted. These overall changes and processes in industry dynamics are excellently represented and summarised by Kurosawa, Wadhwani and Jones, and Decker, who pay close attention to the importance of industry specificity, temporality, and relationships.[47]

1.5.2 State-owned enterprises

The scholarship on state-owned enterprises has also largely omitted airlines from their focus despite ongoing airline privatisation occurring throughout the 1990s and 2000s. As such, there have been many research cases from sectors like railway, telecommunications, and family-owned business.[48] The present study seeks to add to state-owned enterprises

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[46] For example, see Ray Stokes, "Chemical Industries: Changes in Products, Processes, Actors", in *The Oxford Handbook of Industry Dynamics*, by Matthias Kipping, Takafumi Kurosawa, and Eleanor Westney (eds.) (Oxford University Press, 2021); Geoffrey Owen, *The Rise and Fall of Great Companies: Courtaulds and the Reshaping of the Man-Made Fibres Industry* (Oxford University Press, 2010); Jeffrey Fear, *Organizing Control: August Thyssen and the Construction of German Corporate Management* (Harvard University Press, 2005).

[47] Takafumi Kurosawa, "Introduction: Industry history: Its concepts and methods", In *Industries and global competition: A History of business beyond borders*, by Bram Bouwens, Pierre-Yves Donzé, and Takafumi Kurosawa (eds.) (London: Routledge, 2018), pp. 1-24; Daniel Wadhwani and Geoffrey Jones, "Schumpeter's plea: Historical reasoning in entrepreneurship theory and research", In *Organizations in Time: History, Theory, Methods*, by Marcelo Bucheli and Daniel Wadhwani (eds.) (Oxford University Press, 2014), pp. 192-216; Stephanie Decker, "Introducing the eventful temporality of historical research into international business", *Journal of World Business*, Vol. 57, No. 6, October 2022, Article ID 101380.

[48] For example, see Judith Clifton, Francisco Comín, and Daniel Díaz-Fuentes, "From national monopoly to multinational corporation: How regulation shaped the road towards telecommunications internationalisation", *Business History*, Volume 53, Issue 5, 2011, pp. 761-81; John Welsby and Alan Nichols, "The Privatisation of Britain's Railways: An Inside View", *Journal of Transport Economics and Policy*, Vol. 33, 1999, pp. 55-76; Andrea Colli, Esteban García-Canal, and Mauro Guillén, "Family character and international entrepreneurship:

scholarship by presenting the role of the state before, during, and since privatisation in relation to its flag carrier. This is best achieved in relation with an analysis of privatisation processes as the determining factor in ownership developments.

In the few situations where the relationship between flag carrier and government is explored, the predominance of case studies is easy to distinguish. Here, there are examples by Bouwens and Ogier, Vidal, Amankwah-Amoah and Yaw, and Cozmuta.[49] These studies go to great lengths to portray a detailed perspective of the government-flag carrier relationship. Nonetheless, their focus on the singular flag carrier often sets aside the connection with other carriers and comparisons with the industry. By assessing the long-term relationship between BA, Lufthansa, and AF and their governments, this study portrays similarities and differences in terms of how the state plans and reacts to airline privatisation. The study also presents the manner in which governments respond to perceived threats to their flag carriers. In this sense, the analysis is taken further and beyond the single flag carrier cases to provide a broader perspective of the government-flag carrier relationship within the European context.

The study also provides an overview of the most recent COVID-19 pandemic reactions from the British, French, and German governments as a means of demonstrating long-term state involvement within the flag carrier. At the time of writing this study, the COVID-19 situation and its effects upon the airline industry are ongoing. Nonetheless, this event has determined more research which re-assesses the role of governments and that of the EU in the wake of a series of bailouts to flag carriers.[50] This study expands upon this re-assessment by proposing a "too big to fail" type scenario, similar to that experienced by financial institutions during the 2008 Great Recession. This study highlights that flag carriers have historically enjoyed benefits by means of bailouts, favouritisms, and shielding against competition from their governments regardless of ownership. In this current situation, the COVID-19 bailouts have served to expose this matter in the most obvious way.

A historical comparison of Italian and Spanish 'new multinationals'", *Business History*, Volume 53, Issue 1, 2013, pp. 119-38; Mairi Maclean, "New rules–old games? Social capital and privatisation in France, 1986-1998", *Business History*, Volume 50, Issue 6, 2008, pp. 795-810. These cases highlight the relationship between state, privatisation, and the firm, although from the perspective of different industries, while Maclean adopts a broader analysis of the French privatisation experience.

[49] For example, see Bram Bouwens and Frido Ogier, *Welcome Aboard! 100 Years of KLM Royal Dutch Airlines* (Zwolle: W Books, 2020); Javier Vidal, "Latin America in the internationalisation strategy of Iberia, 1946–2000", *The Journal of Transport History*, Vol. 40, No. 1, June 2019, pp. 106-122; Joseph Amankwah-Amoah and Yaw Debrah, "Air Afrique: the demise of a continental icon", *Business History*, Vol. 56, No. 4, 2014, pp. 517-546; Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it".

[50] For example, see Ruud van Druenen, "Permission to bail out EU's national flag carriers? Technocratic and political determinants of commission approval of state aid to national airlines in difficulties in the pre-COVID era", *Journal of Public Policy*, Vol. 42, No. 3, September 2022, pp. 553-72. Van Druenen challenges the orthodoxy of the EU as a pure deregulation actor by highlighting how political factors and state actors may influence outcomes beyond the EU technocratic roles and decisions.

1.5.3 Privatisation processes

Scholarship on privatisation and deregulation, while apt at assessing outcomes, is predominantly not concerned with highlighting the processes behind privatisation, or with the exploration of airline privatisation. This comes as a result of a traditional inclination of privatisation scholarship to research whether privatisation has been successful for the company and/or industry. This tradition developed throughout the 1980s and 1990s as the world's largest economies underwent extensive privatisation programmes. Nonetheless, this tradition persists to this day as Asian economies have been in the process of privatisation and new industries embarked upon privatisation (e.g. airports).

Rather than repeating this tradition or re-appraising privatisation programmes, the present study portrays the main processes behind airline privatisation to understand behind-the-scenes planning and outcomes. The focus on processes is essential for ultimately understanding differences and assessing privatisation outcomes. By studying airline privatisation processes, the study expresses a different and more detailed perspective of airline privatisation than the widespread scholarship focusing on aggregate privatisation outcomes. This approach is found in the works by Megginson and Netter, Bishop and Kay, among other influential scholars.[51] Their approach paints a favourable outcome of privatisation for the profitability and efficiency of companies across various sectors, including energy, banking, and petroleum industries. Nonetheless, the focus on breadth over depth is evident. In the process, however, important details and differentiation between the privatisation experiences of different sectors are overlooked or sacrificed. It is also noteworthy that even within these types of aggregate performance studies, there is an absence of airline privatisation. This is likely due to the ongoing deregulation changes in the sector at the time of appraisal, but also the latecomer status of airlines to the privatisation experience when this sector is compared with other public utilities, such as telecommunications and energy.

This study, therefore, further makes the case of including airline privatisation and specifically its underlying processes within the general privatisation scholarship as the

[51] William Megginson, "Privatization, State Capitalism, and State Ownership of Business in the 21st Century", *Foundations and Trends in Finance*, Vol. 11, 2017, pp. 1-153; William Megginson and Jeffry Netter, "From state to market: a survey of empirical studies on privatization", *Journal of Economic Literature*, Vol. 39, 2001, pp. 321-89; Matthew Bishop and John Kay, *Does Privatization Work? Lessons from the UK* (London: Centre for Business Strategy, London Business School, 1988); Saul Estrin and Adeline Pelletier, "Privatization in Developing Countries: What Are the Lessons of Recent Experience?", *World Bank Research Observer*, Vol. 33, February 2018, pp. 65-102; Ahmed Galal, Leroy Jones, Pankaj Tandon, and Ingo Vogelsang, *Welfare consequences of selling public enterprises: An empirical analysis: a summary* (The World Bank, 1994); William Megginson, Robert Nash, and Matthias Van Randenborgh, "The Financial and Operating Performance of Newly Privatized Firms: An International Empirical Analysis", *The Journal of Finance*, Vol. 49, 1994, pp. 403-52.

industry has become increasingly important in relation to the transport infrastructure and the wider economy. For decades now, privatisation research has been applied to other areas of public utilities when the studies of Beesley and Littlechild, Vickers and Yarrow, Frydman et al. are considered.[52] Consequently, this study especially encourages direct research into the airline industry and privatisation to assess more recent developments in the sector, but also to better understand its industry specificity in relation with other sectors.

As this study points out, the airline privatisation process includes several parties, including employees, international consultancies, and governments. The roles and changes within these parties as a result of airline privatisation is less understood. The study highlights, for example, how international consultancies, like Lazard and Morgan Stanley, represent a cross-national connection between flag carriers in terms of similar and shared privatisation and flotation developments (e.g. choice of IPO as the standard flotation method, deliberate share under-pricing to stimulate demand, employee discounted shares, etc.). This adds to scholarship on the role of consultancies and consultants, found in the research by Kipping and McKenna.[53] In addition to Kipping and McKenna, the present study shows how the same consultancies are featured within the airline industry privatisation process, consequently propagating similar flotation preparations and planning. Furthermore, the research highlights how the status of employees develops from civil servants to shareholders due to the privatisation process. This expands upon the scholarship on the impact of privatisation on employees, which remains mostly concerned on assessing labour productivity outcomes due to privatisation over other developments, although also largely neglects the effects upon airline employees.[54]

[52] Michael Beesley and Stephen Littlechild, “Privatisation: Principles, Problems and Priorities”, [1983], in *Privatisation and Regulation: The UK Experience*, John Kay, Colin Mayer, and David Thompson (eds.), (Oxford: Clarendon Press, 1986), pp. 35-58; John Vickers and George Yarrow, *Privatization: An Economic Analysis* (The MIT Press, 1988), pp. 7-45; Roman Frydman, Cheryl Gray, Marek Hessel, and Andrzej Rapaczynski, “When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies”, *The Quarterly Journal of Economics*, Vol. 114, November 1999, pp. 1153-91.

[53] For example, see Matthias Kipping, “American Management Consulting Companies in Western Europe, 1920 to 1990: Products, Reputation, and Relationships”, *Business History Review*, Vol. 72, No. 2, Summer 1999, pp. 190-220; Christopher McKenna, “How Have Consultants Mattered? The Case of Lukens Steel” (Chapter 3), In *The World's Newest Profession: Management Consulting in the Twentieth Century* (Cambridge University Press, 2006), pp. 51-79. Consultancies have been shaping the way in which operational planning occurs within the firm. However, relationships have been established between consultancies and governments as well. In the present case, not much is yet understood about how these large consultancies operate and build relationships within the airline industry, despite their direct presence in the process. Yet, the study notes the same recurring names within the consultancy world.

[54] For example, see Helena Falkenberg, Katharina Näswall, Magnus Sverke, and Anders Sjöberg, “How are employees at different levels affected by privatization? A longitudinal study of two Swedish hospitals”, *Journal of Occupational and Organizational Psychology*, Vol. 82, 2009, pp. 45-65; Goutam Kumar Kundu and Bidhu Bhusan Mishra, “Impact of reform and privatisation on employees a case study of power sector reform in Orissa, India”, *Energy Policy*, Vol. 45, June 2012, pp. 252-62; Fumitoshi Mizutani and Kiyoshi Nakamura, "Effects of Japan National Railways’ Privatization on labor productivity", *Papers in Regional Science*, Vol. 75, April 1996, pp. 177-99; Bat-Sheva Druk-Gal and Varda Yaari, “Incumbent employees’ resistance to

1.5.4 Alternative theoretical approaches

This study discusses the roles of institutions like governments and industry actors, including international consultancies and their involvement in the privatisation processes. By doing this, similarities and differences are outlined in terms of privatisation staging, processes, motivations behind the sale, and stakeholder participation. As a result, it is important to consider alternative theoretical approaches that contextualise and frame these similarities and differences in terms of privatisation processes and industry dynamics.

The first alternative approach is the literature on Varieties of Capitalism. This scholarship revolves around explaining institutional similarities and differences within developed economies by using typologies. The Varieties of Capitalism debate positions the UK as having the characteristics of a liberal market economy where the market leads economic processes, Germany as a coordinated market economy where the government and market collaborate for long-term stability for example through trade unions and, more recently, France as being driven by state capitalism where market-oriented reforms have established a third-way in which French capitalism becomes "state-enhanced".[55] Indeed, these typologies have been criticised, developed, and enhanced over time through many country-based examples. For example, Nordic capitalism has been positioned as a business system where state and business collaborate under the provisions of developed social safety nets, while Dutch capitalism is described as a type of "soft coordination" where strong labour relations and law continue to exist and influence economic processes.[56] In this sense, the Varieties of Capitalism debate continues to be highly dynamic.

In this study, it is shown that the state continues to be involved in flag carriers and the airline industry regardless of the typology of capitalism described above. Governments like that of the UK, Germany, and France continue to favour and become involved to a certain extent in the operations of their flag carriers. The study terms this flag carrier favouritism. This is especially true with the more recent COVID-19 pandemic. This study also highlights the convergence of privatisation processes between these different flag

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implementing privatization policy", *Journal of Economic Behavior & Organization*, Vol. 59, March 2006, pp. 374-405. Here, the authors highlight how employees are affected by privatisation in various contexts and industries.

[55] Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001), pp. 1-68; Niall MacKenzie, Andrew Perchard, Christopher Miller, and Neil Forbes, "Business-government relations and national economic models: A review and future research directions in varieties of capitalism and beyond", *Business History*, Vol. 63, No. 8, 19 May 2021, pp. 1239-52; Vivien Schmidt, "French capitalism transformed, yet still a third variety of capitalism", *Economy and Society*, Vol. 32, No. 4, 2003, pp. 526-54.

[56] Martin Jes Iversen and Lars Thue, "Creating Nordic Capitalism-The Business History of a Competitive Periphery", in *Creating Nordic Capitalism: The Development of a Competitive Periphery*, Susanna Fellman, Martin Jes Iversen, Hans Sjögren, and Lars Thue (eds.) (New York: Macmillan, 2008), pp. 1-19; Keetie Sluyterman, "Introduction", in *Varieties of Capitalism and Business History: The Dutch Case*, Keetie Sluyterman (ed.) (New York: Routledge, 2015), pp. 1-22.

carriers despite Varieties of Capitalism typologies given the adoption of industry standards like the scale strategy, privatisation consultants, and generally following the “3C’s” framework. As a result, the present study encourages the consideration of industry specificity and industry dynamics when discussing the Varieties of Capitalism typologies as these may provide a nuanced, historical, and filtered approach to contextualising complex business systems.

This Varieties of Capitalism debate may also involve the bandwagon theory. This alternative theoretical approach states that economic participants follow in the behaviour of others as best practices take hold within the business system or industry. In this case, the Varieties of Capitalism typologies may be challenged further or even expanded to include the bandwagon theory. In this case, the bandwagon theory acknowledges that industry changes are cross-national developments that include various international participants, moving beyond the specificities of national economic systems.

There have been many cases from different industries highlighted by business historians of this phenomenon. For example, the international chemical industry began using specialist engineering firms that acted as repositories of intellectual property after the Second World War. These specialist firms acted as linkages and actors for the transfer of know-how in terms of chemical plant design and equipment. In this sense, this best practice was adopted by the main companies in the industry because of its capabilities of quick knowledge transfer.[57] Another example comes from the international electric power industry. Here, electrical equipment manufacturing firms in the U.S. and Germany took on venture risks and developed electric utilities themselves during the late 1880-1890s given the large initial costs of machinery and distribution.[58] If electric utilities were profitable, these were sold at a premium to private investors and the government. Over time, this gave rise to business groups within the industry and associated banks that specifically funded developments within this industry, including the 1895 Bank für Elektrische Unternehmungen (translated as the Bank for Electrical Enterprises) of the German manufacturing firm Allgemeine Elektricitäts-Gesellschaft (AEG).

In this study, the bandwagon theory may be perceived through the presence of cross-national consultancies, including banks, business groups, auditors, brokers, etc. in the privatisation planning process. These consultancies and their expertise in staging and

[57] Ray Stokes, “Chemical Industries: Changes in Products, Processes, Actors”, in *The Oxford Handbook of Industry Dynamics*, by Matthias Kipping, Takafumi Kurosawa, and Eleanor Westney (eds.) (Oxford University Press, 2021).
[58] Chenxiao Xia and Takeo Kikkawa, “Dynamics of the Electric Power Industry: Emergence and Continuity of a Socio-Technical System”, in *The Oxford Handbook of Industry Dynamics*, by Matthias Kipping, Takafumi Kurosawa, and Eleanor Westney (eds.) (Oxford University Press, 2021).

planning flotation and privatisation contributed to the wider propagation of the IPO model among flag carriers. Furthermore, their expertise involved staging and offering discounted shares and employee share schemes to stimulate demand in the sale. The roles of these consultancies are discussed in chapters 3, 4, and 5 with specific reference to BA, Lufthansa, and AF. In this sense, the use of international consultancies in staging flag carrier privatisation is an observed commonality in the civil aviation industry, leading to a convergence of privatisation processes and planning. Nonetheless, there are challenges in accessing consultancy information and the extent of their involvement in the privatisation process the due to the presence of confidentiality clauses.

The adoption of the scale strategy as an industry standard due to the competitive pressures of deregulation within the industry has also been common. BA, Lufthansa, AF, and other major flag carriers embarked upon the scale strategy as the best means of surviving competition. This wide adoption of the scale strategy contributed to the development of the "3C's" framework through cooperative agreements like code-sharing and other mechanisms, as detailed above. Chapter 4 on Lufthansa highlights a slightly different scale strategy based on accelerated consolidation first by means of code-sharing agreements over cross-investments which were pursued by BA. Nonetheless, Lufthansa later pursued acquisitions as well under the Lufthansa Group.

In the above examples of alternative theoretical approaches, flag carrier privatisation and deregulation have been shown to imprint their own characteristics upon the Varieties of Capitalism debate and the bandwagon theory. In terms of Varieties of Capitalism, this study shows that attention to industry dynamics and industry specificity are essential toward describing historical complexities, moving past typologies. In terms of the bandwagon theory, there has been a convergence of privatisation and deregulation processes due to key actors in the staging of the sale, but also due to the dynamics of the industry and the scale strategy pursued by flag carriers. While the focus of this study belongs to the perspectives on industry dynamics, state-owned enterprises, and privatisation processes, these alternative theoretical approaches are nonetheless worth mentioning for the value they bring in terms of enhancing the discussions and interpretations of this industry.

Overall, the study notes several different areas where airline privatisation processes have been neglected over time despite the increased role of flag carriers in the transport infrastructure. Throughout the following chapters, the study addresses these main points and returns to them in the conclusion chapter.

1.6 Methodology

This study employs qualitative (e.g. historical analysis of archival material, discourse, official reports, documents, interviews, etc.) and quantitative analysis (data and statistical evaluation of numerical information, including datasets, financial reports, industry and airline data, etc.) to answer the main questions. All French and German translations to English throughout the chapters are the work of the author of this study.

Flag carriers are chosen as the focus of the study given their ownership configuration developments, historic relationship with governments, and important role in shaping industry dynamics. The research revolves around the airline passenger business as it represents the driving factor behind flag carrier operations in terms of revenue. The cargo or freight sector has developed differently in the context of deregulation. Those developments are also worthy of consideration, albeit they deserve a different treatment than what is permitted here.[59]

The study makes extensive use of visual information and representations (tables, quotes, pictures, graphs, etc.) throughout the chapters to portray developments over time. In terms of resources, primary sources are heavily relied upon to provide first-hand accounts and data from the governments and airlines. These sources include the following:

- Materials from the UK, French, and German National Archives, including documents from the UK Prime Minister's Office, Board of Trade and Treasury files, the French Economic and Financial Archives, etc. These have been used to understand the government's planning and involvement in the privatisations;

- Company archives, including BA privatisation records, Lufthansa internal documents and staff newspapers, and AF general management files, among other important documents. These are used to understand the intra-firm strategies, flotation planning, management reactions, the involvement of international consultancies, etc.;

- International organisation reports from bodies such as the EEC, the UK Civil Aviation Authority, the IMF, the UK National Audit Office, etc. These are used to portray industry dynamics, privatisation flotation outcomes, and developments in the "3C's" framework;

[59] For an overview of air cargo deregulation in the U.S., see Clinton Oster Jr. and Robin Miles-McLean, "Air Cargo: Impacts of Adapting to Deregulation", *Transportation Research Record*, No. 1147, November 1977.

- News media, including the Financial Times, Reuters, the UK Guardian, New York Times, Le Monde, etc. These are mainly used to understand the media reaction related to the privatisations, COVID-19 bailouts, and framework developments in the industry, among other aspects;

- Other archives and archival material, including documents housed at university repositories to supplement existing material. For example, the study uses material from the Churchill College Archives, University of Cambridge to understand political economy information related to the sales, including government involvement in the sales, privatisation motives, and ideology.

The structure is the following: Chapter 2 highlights the background and history behind the European airline industry before deregulation. Chapter 3 examines the privatisation processes encountered by BA, the first major full airline divesture in the European context. Chapter 4 continues the privatisation story with Lufthansa and its successful privatisation experience in the context of political and deregulation pressures. Chapter 5 details how AF has remained with a sizable French government stake in the context of liberalised European markets and despite partial privatisation and the KLM merger. Chapter 6 concludes the study and proposes several avenues for future research.

Chapter 2. The Development of the International Airline Market: Industry Dynamics, Regulation, and Liberalisation

In this chapter, the context and history of international regulatory and governance changes from inception to the present-day operating framework is discussed to understand how the industry developed. As part of this, the pre-1980s industry dynamics, how airlines operated before the deregulation drive, and the resulting outcomes are explored. Thereafter, the history of airline privatisation within the European setting is discussed to understand the major airline industry developments and the timing related to the intensification of privatisation.

The context and background of the international airline sector is important to consider for several reasons:

First, it is acknowledged that the industry and regulatory frameworks have been dynamic over time. In return, this has substantially changed the manner in which airlines operate, their incentives, their motivations to privatise, and even the outcomes in terms of governance and performance. As such, the flag carrier of the past does not conduct their operations in a similar manner as the ones from the 1980s or the airlines of the present.

Second, understanding the context and background allows the finer portrayal of developments over time and brings out the importance of temporality within research. Because of this, the chapter benefits from telling a more nuanced story.

Last, researchers can assess to what extent the industry has progressed by looking back at the past as well as the turning points in its history. These results and considerations for background and context can then be used in a comparative manner to study past events and outcomes for the benefit of present and future policy-making lessons.

2.1 Regulation and liberalisation within the international airline industry

The history of air regulation and liberalisation can be divided into several key periods: the emergence of the regulatory system before and during the Second World War, the dominance of the bilateral service agreements system after the Second World War, and the gradual liberalisation and so-called Open Market and Open Skies arrangements after 1980.

2.1.1 The emergence of airline regulation, 1910-45

The role of the early fixed-winged aircraft of the 1910s was very limited in scope compared to today's carriers. For instance, the early aircraft could only fly for several miles and mainly carried cargo not passengers. Because of this and the emergence of a new industry, there were underdeveloped regulations related to how an airline should operate within the airspace of a country. It also brought about unanswered questions related to the air sovereignty of a country and the ownership of a flag carrier.

The First World War complicated these questions in several meaningful ways:

First, the advances in engine and fuel technology due to the war effort meant that aircrafts could now fly for longer and cover larger distances.[1] This meant that flying across borders was now possible to some, still limited, extent.

Second, the Great War developed the role of the aircraft. Cargo and military equipment transportation were common, although the aircraft would now also be utilised for military surveillance purposes. Aircraft capacity increased and with it the ability to deploy very rudimentary bombing capabilities, which eventually had a more pronounced and strategic role during the Second World War.

Last, nations were now increasingly aware of the importance of aircraft as well as the safety and sovereignty of their own airspace.

During and immediately after the war, new airline companies were founded dedicated to scheduled passenger services. This marked an important development in the history of civil aviation and a closer step toward the role fulfilled by contemporary airlines. For example, KLM is the oldest surviving airline which operated its first scheduled passenger services on 17 May 1920. The service departed from London to Amsterdam, with the pilot, 2 journalists, a letter from the Mayor of London to his Amsterdam counterpart, and a stack of newspapers on board.[2] Starting 1924, just a few years later after its first flight, KLM began operating its first intercontinental flight between Amsterdam and Jakarta,

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[1] BBC, *Viewpoint: How WW1 changed aviation forever*, October 2014, Retrieved from https://www.bbc.co.uk/news/magazine-29612707 [Accessed on 16 January 2023].
[2] KLM, *History of KLM*, Retrieved from https://www.klm.com/information/corporate/history [Accessed on 16 January 2023].

Indonesia. It represented another milestone for civil aviation as trans-oceanic flights were now a reality. The growing importance of the aircraft, their increasingly passenger-oriented role, and the newfound dilemma related to air sovereignty would all culminate in the 1919 Paris Convention agreements.

In 1919, leading nations such as France, the UK, and Japan, among others, met in Paris to discuss airspace rights. They agreed that "every Power has complete and exclusive sovereignty over the air space above its territory" and that no aircraft was to be permitted flight above a country's territory "which does not possess the nationality of a contracting State".[3] The first important pieces of airline regulation law were put in place, alongside the creation of the International Commission for Air Navigation (ICAN), the first organisation concerned with the safety and functioning of international civil aviation, and a precursor to other aviation organisations yet to come.[4]

What followed was direct government intervention in air transport through a series of bilateral agreements, or bilaterals, between countries. These agreements ensured that only particular airlines were allowed to fly within the airspace of a nation and under very specific restrictive conditions, such as tariffs and other barriers to entry. The tariffs and regulations were agreed upon between states. This more prominent role of governments within civil aviation and airspace rights tied to nationality also explains the common and widespread pattern of state-owned airlines at the time. In Europe, for example, the majority of airlines formed before the Second World War were either fully or majority owned by a government. The governance of this sector, then, was predominantly under state ownership given the strategic importance to each respective country and the state's position in negotiating these conditions. These points are discussed in the following section. While a step toward airline sovereignty, these initial regulations were deemed restrictive for the functioning of airlines due to the highly regulated traffic rights, tariffs, and access to markets. In return, this brought about fears of uncompetitive and monopolistic behaviour on air routes.[5]

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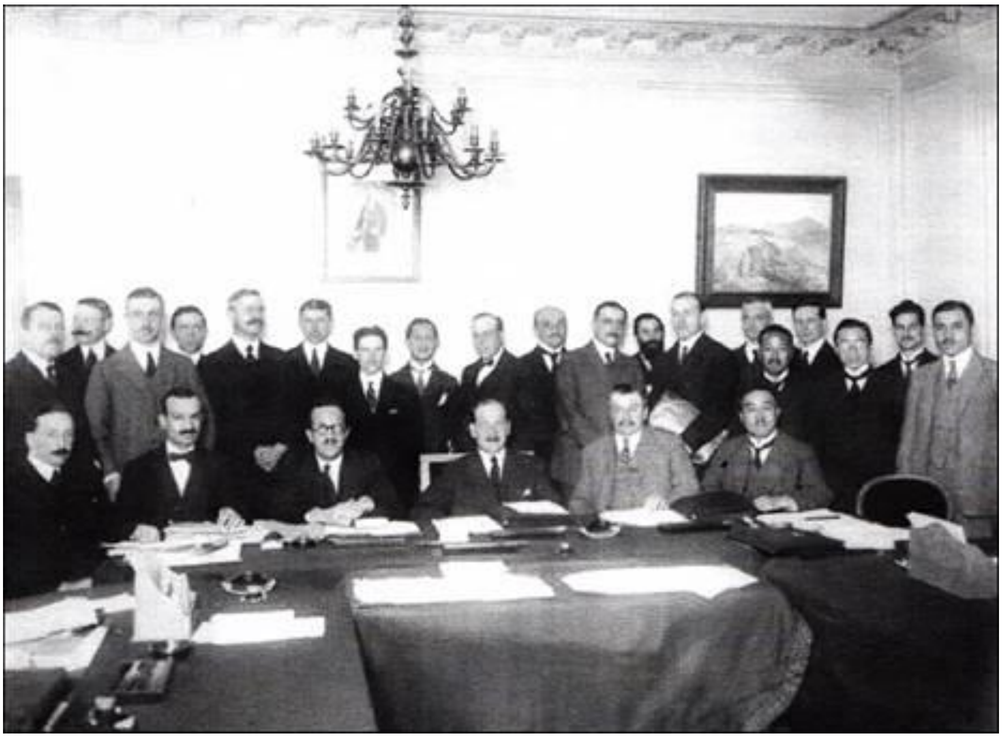
[3] Convention Relating To The Regulation Of Aerial Navigation Signed At Paris, 13 October 1919.

[4] Albert Roper, 'The Organization and Program of the International Commission for Air Navigation (C.I.N.A.)', *Journal of Air Law and Commerce*, Volume 3, Issue 2, 1932, pp. 167-78.

[5] Rigas Doganis, *Flying Off Course: Airline Economics and Marketing* (Routledge, 2010), Chapter 2.

Picture 2.1 The 1919 Paris Convention and its delegates.[6]



The limitations of this incomplete bilateral system meant that a more liberal agreement was still sought after by certain parties, including the U.S.. However, there were no breakthroughs during the inter-war period.

The context of another world war would bring airlines back in the spotlight. The Second World War reconfirmed the U.S. as the first world superpower. Because of their importance in winning the war and substantial leverage in the civil aviation industry, the U.S. intensified its pursuit of more liberal agreements. The context is noteworthy as to why the U.S. pushed for these new agreements. For instance, there were many new airlines founded during the interwar period including several major U.S. carriers, such as Pan American, Delta, and American Airlines. This brought the U.S. at the forefront of competitive carriers given their relatively swift developments in airline capacity and their economies of scale. However, the Second World War also left the U.S. civil aviation infrastructure largely unharmed and especially competitive compared to the European counterparts, which had to deal with the aftermath of war.

The distinctions between U.S. and European governance of the sector mark a stark contrast. The U.S. airlines were not nationalised. Indeed, Pan American was the *de facto* international flag carrier of the U.S. during this period given its access to more preferential routes, including air mail. Yet, Pan American was not state-owned. Rising domestic entrants

[6] International Civil Aviation Organisation, 1919 Paris Convention (Montreal: ICAO Archives), Made available to the public.

from other U.S. carriers meant that this large market was already becoming more competitive than the European domestic markets. This relative stability did not give the U.S. government reason to radically intervene and change their position on governance. The U.S. carriers were developing during this period as a result of their intact and large domestic market compared to their European counterparts. In Europe, concerns of air sovereignty and a weakened market meant that the status quo of state ownership would still be in place for the time being.

It is interesting to note during this period that the European airspace can be perceived as less competitive than the U.S. also due to governments shielding their flag carriers. In this case, a more rigid dynamic is observed where state intervention and protectionism often lead to the formation of a domestic monopoly. These were the beginnings of the privileged legacy carriers. The flag carriers of Europe enjoyed their advantageous position, being awarded with preferential routes. It took several decades for the dominance of European flag carriers to be eroded. Gradual deregulation would eventually follow even if this would not be related to ownership changes within the sector.

Non-regulatory factors were, to some extent, also at play in determining the state and competition of the market. This is not the focus of the discussion here, but this study reminds that governments also awarded gate access rights at key airports as example. These airports were also under the ownership of the state at this time. Because most traffic was concentrated at select airports, flag carriers would also have their hub assigned to these places. This adds a further dimension to hindering new entrants and competition.

In 1944, 52 member states convened in Chicago to negotiate a more liberal agreement. The U.S. wanted to make use of their favourable circumstances to propose little to no tariff controls, increased exchange of traffic rights, and more capacity and frequency rights. The result, however, was a compromise. There were European countries, like the UK, which did not agree with the U.S. proposals due to their weaker civil aviation position.[7] Nonetheless, bilateral agreements would now become the norm in civil aviation. The Chicago Convention also founded the successor to ICAN, the ICAO, which functions to this day as the body which oversees and coordinates international operations and safety standards.

Importantly, the Convention introduced the first five *Freedoms of the Air*. These were a standardised set of rules which now form the basis for commercial air policy. Over time and due to deregulation, the original five freedoms have expanded to nine freedoms, although only the first five have been officially recognised by international treaty. These are defined by the ICAO as:

[7] Chicago Convention on International Civil Aviation, 7 December 1944.

First Freedom—the right to fly across a foreign state without landing.

Second Freedom—the right to land in a foreign state for non-traffic purposes (e.g. refuelling, maintenance).

Third Freedom—the right to fly from the home state to a foreign state.

Fourth Freedom—the right to fly from a foreign state back to the home state.

Fifth Freedom—the right to fly between two foreign states on a flight originating or ending in one's own state.

Sixth Freedom—the right to fly from a foreign state to another while stopping in one's own state for non-technical reasons.

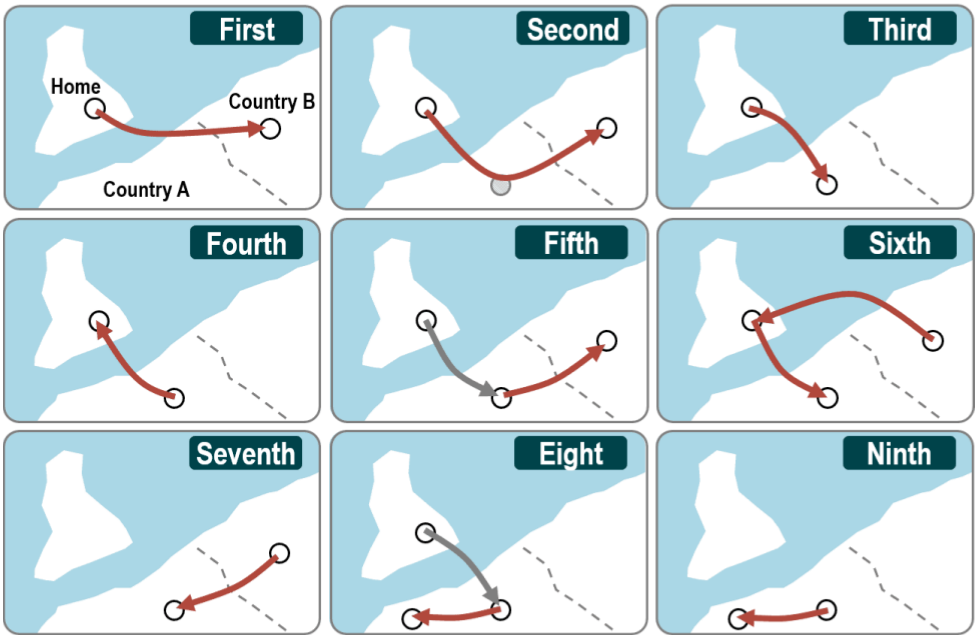
Seventh Freedom—the right to fly between two foreign states, where the flight does not have to operate in one's own state.

Eight Freedom—the right to fly inside a foreign state, having originated from or continuing to one's own state.

Ninth Freedom—the right to fly within a foreign state without continuing to one's home state.

These are represented in Figure 2.1:

Figure 2.1 The Freedoms of the Air.[8]



The member states adopted the framework of bilaterals for the post-Chicago Convention period. However, there were still attempts at further deregulation of the international air market before the more pronounced liberalisation drive of the post-1980s period. This is explored in the following sub-section.

2.1.2 The bilateral air service agreements, 1945-80

The bilaterals of the 1945-1980 were the status quo in civil aviation industry of the time. Yet, there were countries, such as the U.S. and Canada, which continued to argue for more liberalisation. One year after the Chicago Convention, both of these countries sat in agreement and continued to be vocal at the 1945 meeting of the Interim Council of the Provisional International Civil Aviation Organization (PICAO):

> We believe that there must be greater freedom for development of international air transport and that this freedom may best be obtained within a framework which provides equality of opportunity and rewards for efficiency.[9]

In 1946, the PICAO commissioned research on the viability of liberal provisions concerning routes, airports and capacity, although these were only formulated in a draft

[8] Figure copyright by Jean-Paul Rodrigue, Claude Comtois, and Brian Slack, *The Geography of Transport Systems* (New York: Routledge, 2020), Fifth Edition, Chapter 5; The Five Freedoms summarised by William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition, p. 49.
[9] Provisional International Civil Aviation Organization Proceedings, Volume 1, Doc 1, Montreal, 1945.

format and no agreement was reached.[10] It was hoped by the U.S., Canada, and other countries which either had a competitive airline industry or a small domestic market, such as the Scandinavian countries, that the previous limitations of Chicago and PICAO would not harm the ideal of liberalisation at the 1947 Geneva Conference. Once again, the U.S. and several interested members proposed a system of more liberal agreements on air tariffs, capacity, and traffic rights. By the end of the meetings, the 30 participating countries were at an impasse. Once again, the liberal agreements ideal was met with failure.[11] The outcomes of Chicago, PICAO, and Geneva highlighted the precarious balance between the freer market approach proposed by the U.S. side and the more protectionist tendencies present within the European setting. Bilateralism was here to stay.

However, some of the Chicago restrictive bilateral clauses were bypassed relatively soon after 1946, as the U.S. took matters into their own hands.[12] The U.S. and UK engaged in a bilateral agreement which marked a compromise between the two stances. Called the Bermuda I Agreement after the overseas British territory in which it was signed, the bilateral was not as exciting or daring in liberalising civil aviation between the two countries as the original proposals by the U.S.. Nonetheless, the agreement marked one of the earliest examples of a more liberal bilateral between two countries, which eventually served as a template for subsequent bilaterals. This was so for several reasons:

First, the U.S. and UK agreed that tariff-setting should be devolved to and regulated by IATA rather than leaving it unregulated.

Second, there were no longer limitations on the frequency and capacity of flights contingent upon public demand.

Last, there were more travel rights awarded like the *fifth air freedom* to carry revenue over other countries (i.e. former British territories like Hong Kong, etc.). These clauses formed the basis for future bilaterals as the Bermuda I agreement was "achieving multilateralism through bilateralism" to an extent.[13]

Yet, concerns of restrictive competition, tariffs, and capacity eventually led the U.S. to pursue increased liberalisation through a renegotiation of bilaterals. This came in a new context of other airlines, such as Laker Airways and British Caledonian (BCal), that wanted to operate routes to and from the U.S., but also under the 1978 U.S. market deregulation. For

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[10] Provisional International Civil Aviation Organization, Views of Commission No. 3, Document 4023, Montreal, 1947.

[11] Robert McClurkin, Adviser to the United States Delegation at the Geneva Conference, "The Geneva Commission on a Multilateral Air Transport Agreement", *Journal of Air Law and Commerce*, Volume 15, Issue 1, 1948 pp. 39-46.

[12] Agreement Between the Government of the United States of America and the Government of the United Kingdom Relating to Air Services Between Their Respective Territories, Feb. 11, 1946, U.S.-UK, Statute 1499.

[13] Ruwantissa Abeyratne, "Would Competition in Commercial Aviation Ever Fit into the World Trade Organization", *Journal of Air Law and Commerce*, Volume 61, Issue 4, 1996, pp. 793-857.

example, Pan American would lose its de facto international flag carrier role in favour of pronounced competition from other more efficient airlines, including Delta and new LCCs such as Southwest.

Under Bermuda I, only a select few airlines, such as BA and Pan American, were allowed to fly between London and the U.S.. In 1977, the Bermuda II agreement was signed. Bermuda II and subsequent bilaterals pursued the U.S. liberalisation and competition aim in several new ways. Unlike the first agreement, there were now two airlines rather than one allowed to operate on the same routes.[14] To protect smaller airlines, such as Laker Airways, for being undercut at market entry by the larger airlines, provisions against predatory pricing were included. Charter rights between the two countries were also allowed, while new gateway points and traffic rights were agreed upon and further expanded to reflect growing transatlantic demand. From 1978 onwards, the U.S. renegotiated its international bilaterals by "picking off a country at a time".[15] The renegotiation included deals with European and Asian countries. This progress in starting the liberalisation process of domestic and international airline markets, however, would not go to waste. Instead, a more pronounced liberalisation drive would be sustained from other parts of the world as well, but only after 1980. Nonetheless, the pre-1980s can still be described as restrictive. In the next sub-section, the study considers why this was the case as well as the resulting outcomes determined by this system.

2.1.3 Industry dynamics before the 1980s

The status of national flag carrier emerged, as only select airlines approved by their domestic government could operate certain routes and "fly the flag". However, this designation confined the role of the European airline to that of a public utility for the majority of this period.

Because of this strategic role, the ownership of the major European flag carriers was overwhelmingly similar (Table 2.1).

[14] Consolidated Air Services Agreement Between The Government Of The United States Of America And The Government Of The United Kingdom Of Great Britain And Northern Ireland, Bermuda II of July 23, 1977.
[15] Rigas Doganis, *Flying Off Course: Airline Economics and Marketing* (Routledge, 2010), p. 45.

Table 2.1 Top 10 European airlines by total international passenger traffic and ownership, 1981.[16]

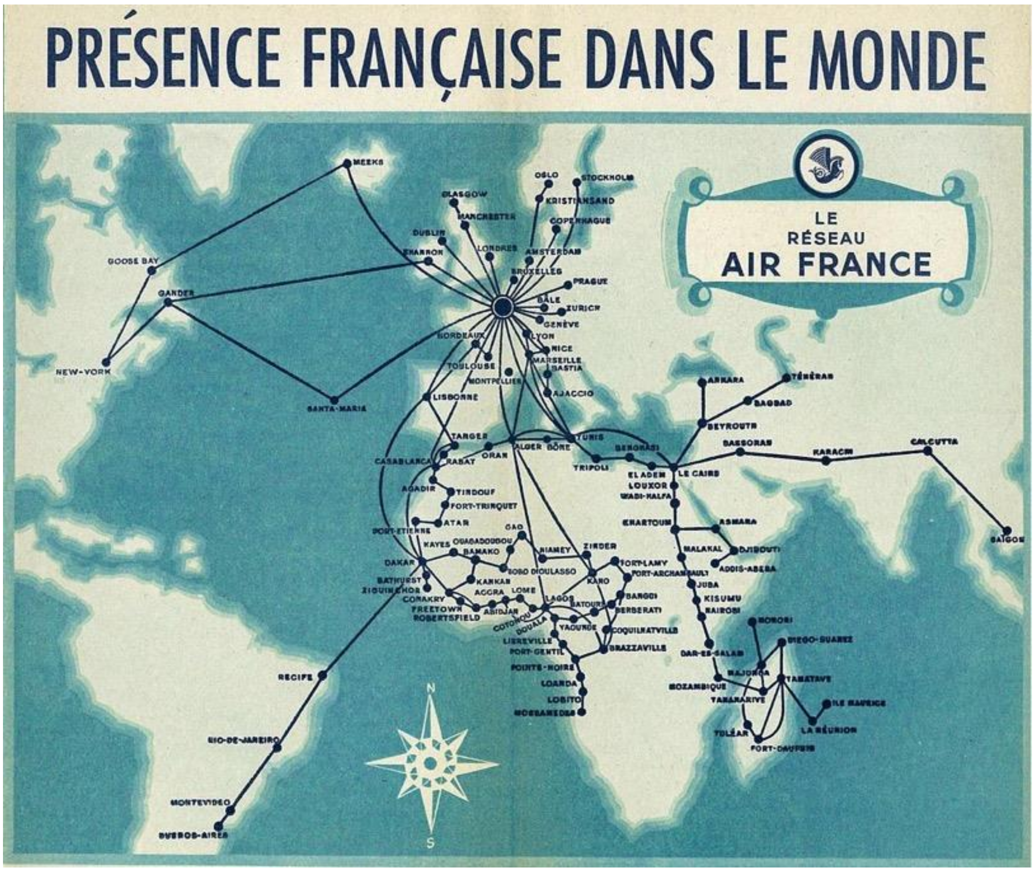
Passengers (in thousands)	Flag carrier	Country	Ownership
15,305	British Airways	UK	100% public
13,208	Iberia	Spain	100% public
12,964	Lufthansa	Germany	100% public
11,565	Air France	France	100% public
8,416	Scandinavian Airlines	Denmark/Sweden/Norway	50% public
6,985	Alitalia	Italy	100% public
6,221	Swissair	Switzerland	100% public
4,901	Olympic	Greece	100% public
3,989	KLM	Netherlands	100% public
3,271	Jat Airways	Former Yugoslavia	100% public

The European flag carrier had cabotage rights, meaning it was the only airline allowed to operate internal routes, effectively banning foreign entrants. However, the short distances coupled with high fares made railway travel cheaper and more practical, putting flag carriers at a disadvantage. Indeed, there were instances where managers from AF, KLM, and BA complained about unused excess capacity and unprofitable domestic routes, only to be criticised and pressured by the government to maintain route operation.[17]

The European flag carrier also flew within a more rigid international route network, where routes were not necessarily profitable. Many of these routes were linked to colonial networks and the strategic transport of dignitaries, passengers, and cargo. For example, AF and had extensive route operations within north African territories (Figure 2.2).

[16] Der Lufthanseat, Lufthansa staff newspaper, August 1982, (Cologne: Lufthansa Archives), p. 6.
[17] Martin Staniland, *Government Birds: Air Transport and the State in Western Europe* (New York: Rowman and Littlefield, 2003), p. 101.

Figure 2.2 Air France 1947 route network.[18]



A similar story is seen with the British Overseas Airways Company (BOAC), one of the precursors to BA, and several Asian and South African routes. Once decolonisation had begun, many of these routes were dropped by the late 1960s. European flag carriers with a colonial history reoriented their operations to North America.

Because of its extended network and representation abroad, the flag carrier imparts additional meaning to the public utility role, more than what was possible trough domestic-bound transportation. The flag carrier was a representative of the home nation abroad, a symbol of national pride, and an effective instrument for tourism. Barrett exemplifies this when examining how Aer Lingus, the Irish flag carrier, symbolised national identity: “The Irish holiday experience began not on arrival in Ireland but on boarding an Aer Lingus flight”.[19] BOAC and later BA sold postcards of their destinations with their planes printed on them as an early advertising method. Airline liveries included national flags and symbols (e.g. Irish shamrock). The flag carrier was bound to represent one national identity and be in its service rather than a transnational airline.

The operations of the flag carriers of the past were not only restricted by their roles as public utilities and national representatives. Fixed fares, capacity restrictions, and market

[18] Air France 1947 World Route Network Map, Airline Timetable Images, compiled by Björn Larsson.
[19] Sean Barrett, *Deregulation and the Airline Business in Europe* (London: Routledge, 2009), pp. 105-6.

presence were among the main barriers in the operations of a flag carrier. Governments approved fares through IATA, an organisation of airlines which established the air fares. While IATA was an international endeavour, the approval of fares by governments was decisive. This was done in the interest of avoiding predatory pricing on interrelated routes. In effect, however it left flag carriers without the possibility of operating discounted fares, leading to overall high fares within the industry.

Governments also maintained capacity restrictions via bilaterals on how much an airline could operate a designated route. This meant that flag carriers would often run into situations of not being able to effectively match demand.

Capacity restrictions meant that select airlines were allowed to service routes. Only 2% of routes had more than one airline servicing per state.[20] This led to an industry full of monopoly flag carriers with stifled competition. In this absence, new entrants were not allowed to challenge them. While this absence of competition may, at face value, benefit flag carriers on longer routes, it ultimately results in higher operating costs and more expensive fares to consumers due to a lack of incentives from flag carriers to perform more efficiently. The study returns to these effects later in the upcoming sub-section when outcomes are addressed.

International cooperation, alliances, and mergers between airlines were precluded by being public utilities in the service of one nation. Nationality clauses were an important part of government negotiation on air traffic rights and in approving flag carrier operations. The majority of the ownership had to be of national origin to prove that this was indeed one nation's flag carrier to receive traffic rights. Foreign investment in an airline was also highly curtailed on grounds of national sovereignty and a fear of foreign takeover, being kept to a legislated minimum. The flag carriers also did not have an incentive to challenge these international regulations and push for strong cooperation and alliances given the lack of a competitive threat and the protection they enjoyed from governments.

These elements discouraged cooperation, alliances, and the formation of transnational carriers. In this situation, the "3C's" industry framework had not been realised. By 1980, less than 2% of the airlines in the industry accounted for transnational carriers and these were special circumstances where small or close domestic markets needed servicing, such as Scandinavian Airlines (SAS) and Gulf Air.[21]

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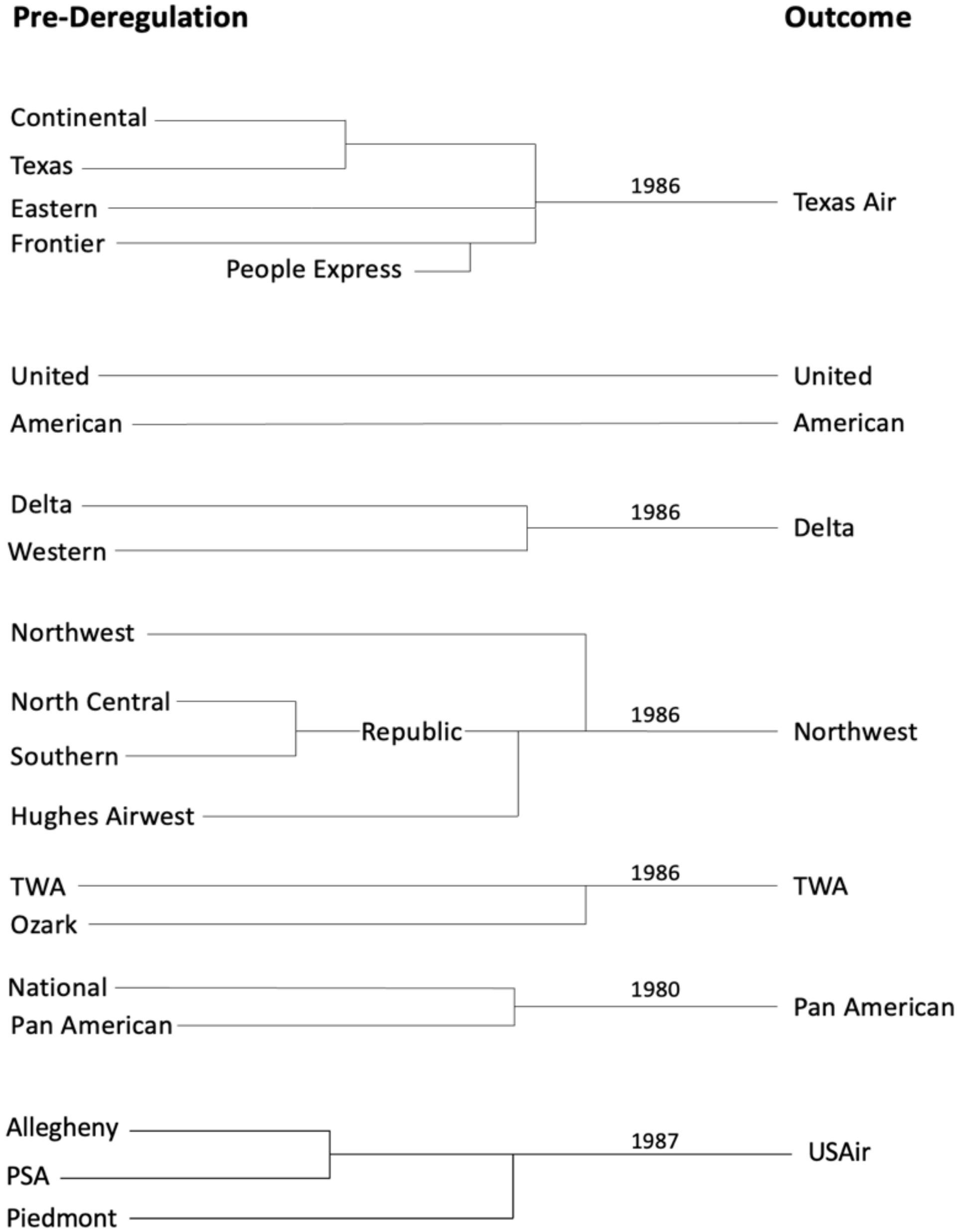
[20] European Civil Aviation Conference, *(The Compass Report) Report of the Task Force Oil Competition in Intra-European Air Services* (Paris: ECAC, 1981).

[21] Sean Barrett, *Flying High: Airline Prices and European Regulation* (Aldershot and London: Avebury Publishing and the Adam Smith Institute, 1987), p. 10.

Around the early 1980s this starts to change because of liberalisation in the sector. However, this would come from North America first. The U.S. airline deregulation of 1978 under President Jimmy Carter led to pronounced concentration of airlines in the North American market.[22] This transpired due to the removal of federal curtailment on routes, fares, and market entry. Market competition was now opened in the U.S. market. In 1979, there were 19 main U.S. carriers. By 1986, 9 mega-carriers focused on economies of scale, including United, American, and Delta led the domestic market (Figure 2.3). As noted in the following chapter, this U.S. deregulation drive worried BA and the other European flag carriers, which were realising in the late 1980s that U.S. deregulation and the threat of mega-carriers would ultimately change the competitive structure of the industry. This was a pronounced worry especially on transatlantic routes during the late 1980s. As the study shows in future chapters, European flag carriers would eventually seek to ally and cooperate with these mega-carriers as part of their scale strategy.

[22] Peter Belobaba and Amedeo Odoni, "Introduction and Overview", in *The Global Airline Industry*, Peter Belobaba, Amedeo Odoni, and Cynthia Barnhart (eds.) (Chichester: John Wiley & Sons, 2009), pp. 1-17.

Figure 2.3 Consolidation of the U.S. Airline Industry, 1979-87.[23]



Besides the bilateral agreements which governments largely decided and state influence on airline strategy, this study also briefly highlights how government policy-making also maintained the status quo in the industry. This was done through ideology and the social contract of securing employment.

The post-war consensus of Keynesian economic intervention and the ideology of social democracy meant that the state was very much involved in the functioning of the economy on accounts of financial and public regulation, providing social welfare, and maintaining ownership of strategic sectors. It was a response to the outcome of the Second

[23] Data from Hoare Govett Limited, May 1987, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 53; For a breakdown of the revenues of these U.S. carriers for the year 1987, please consult William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition, p. 10, Table 2.

World War and the need to recover and revitalise Europe, but also a mission to provide an equitable socialisation of capital. The task was up to the governments to prompt the economy, secure employment, and serve national demands.

This transpired into a series of nationalisations aimed at keeping control of the largest public utilities, including energy, telecommunications, water authorities, aerospace, etc. in the name of providing fair access to services often under fixed fares, but also due to national security and sovereignty concerns. Indeed, this was the case for the transport sectors of the European economies. For example, the UK Labour government nationalised railways, road transport, and inland waterways in the 1940s and 1950s.[24] Similarly, France nationalised civil aviation (AF), railways, in addition to other sectors, including energy and banking by the late 1950s.

Government policy-making and the need to uphold the social contract of providing more equitable social welfare left public utilities with a heavy administrative burden–committing to maintaining high levels of employment. This government priority imposed upon public utilities led to overstaffing, complex and often redundant bureaucratic organisation in the form of long management chains and additional branches. There was also a lack of productivity incentives by not linking pay to performance, effectively leading to lagging labour productivity. Among flag carriers, this was also a common problem. BA's staff numbered close to 60,000 by the end of the 1970s, while the European airline industry was overmanned by more than 93,000 staff compared to North America judging by productivity level comparisons.[25] This resulted in higher costs per worker and ultimately higher fares.

Governments, however, were aware of this costly aspect. In 1969, a cost-benefit analysis of Aer Lingus and its operations argued that the flag carrier role of securing employment to the detriment of costs, especially within the context of a country facing high unemployment at the time, would be a justifiable aspect of a flag carrier's mission.[26]

This aim, however, effectively confined the government into susceptibility to staff and union demands. This would happen whenever cyclical events occurred, or new policy changes were considered. As portrayed in Chapter 4 on Lufthansa, the German government's attempt to privatise Lufthansa caused concerns among its staff because of a fear of losing state-backed pensions. In the larger economy, changes to the ownership of a public utility

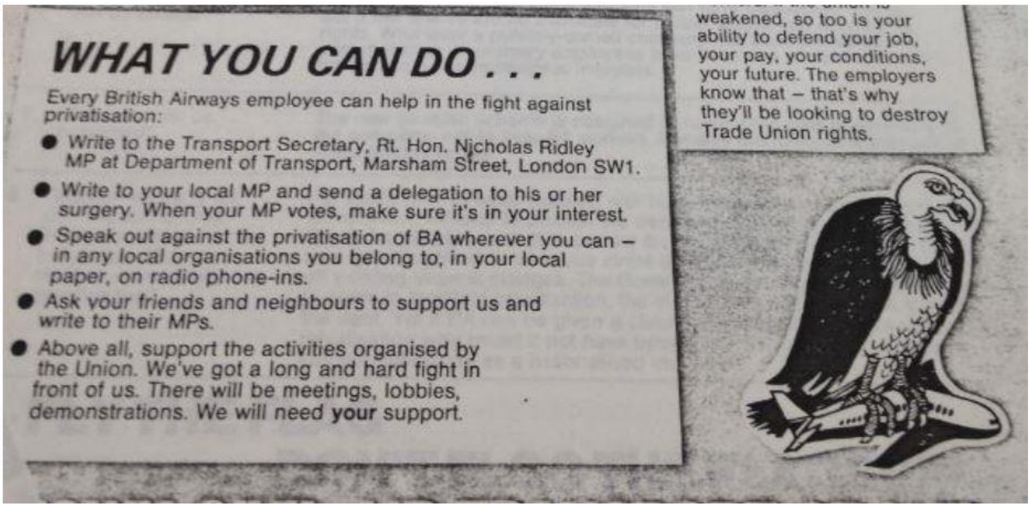
[24] Cabinet Conclusion 4. Nationalisation of Transport, 4 July 1946, CAB 128/6, (Kew: The UK National Archives, 1946).

[25] Sean Barrett, *Flying High: Airline Prices and European Regulation* (Aldershot and London: Avebury Publishing and the Adam Smith Institute), p. 39.

[26] Martin O'Donoghue, "A cost-benefit evaluation of Irish airlines", *Journal of the Statistical and Social Inquiry Society of Ireland*, Vol. 22, pp. 155-80.

were often met with worry and union action. An example of this is included in a UK transport union advert (Picture 2.2). Workers associated privatisation with a loss of rights and earning power, as well as redundancies. Nationalisation acted as a safety net in this case, especially as employees could organise themselves and protest changes, ultimately to the detriment of the ruling party.

Picture 2.2 UK transport union encouraging BA workers to reject privatisation.[27]



Flag carrier managers were also decided by governments. In this case, there were often situations where managers were appointed politically, being especially susceptible to government policy-making and ideology, and often culminating with conflicts of interest. Surrounding the managerial levels of a public utility with "yes-men", meant that government policy-making would mostly go unchallenged. Furthermore, the flag carrier's fleet acquisition policies were also influenced by government involvement in multinational endeavours, such as the 1960s Airbus aircraft manufacturing consortia between the British, French, and German governments. For example, Chapter 4 on Lufthansa shows how the Bavarian state government initially opposed Lufthansa's privatisation in the early 1980s as they believed a private airline would acquire Boeing over Airbus aircraft, therefore endangering Bavarian manufacturing employment. At the same time, however, the same state government argued that the nationalised Lufthansa management was already operating according to private sector demands.[28] Consequently, managers had their hands tied on what they could accomplish given government policy restrictions. This changed because of privatisation, where managers have been able to exert influence in the long-term strategy of

[27] UK Transport and General Workers' Union, *Why all British Airways Workers should say No To Privatisation*, 4 January 1984, Archive Box N465, (Heathrow: British Airways Archives, 1984), Reprinted with permission.
[28] Interview with Franz Josef Strauss, Bavarian Minister-President, on Lufthansa Privatisation, *Flug Begleiter (Frankfurt)* magazine, December 1984, Bundesarchiv B126/143239, Federal Ministry of Finance.

the flag carrier. In chapters 3, 4, and 5 the role that managers had in privatisation planning and in establishing the scale strategy for BA, Lufthansa, and AF is discussed. As these chapters note, these flag carriers followed a similar scale strategy, being informed by the early BA example. In the following sub-section, the outcomes of this restrictive system are considered.

2.1.4 Outcomes of pre-1980 industry dynamics

The difficulties that many of the European flag carriers encountered were indeed of a common nature. In fact, these issues are often described in literature under the term "distressed state airline syndrome".[29] The following are discerned:

The flag carriers struggled with high operational costs due to inefficient allocation and utilisation of routes, as well as the lack of price competition and the incentives to drive down costs. Research from international civil aviation bodies, such as the Association of European Airlines, has compared the U.S. deregulated market of the late 1970s with the highly regulated early 1980s European markets. In this 1981 comparison by the UK Civil Aviation Authority (CAA), it was found that European costs were 74% higher than the U.S. on routes of similar distances. Another study reconfirms this data by highlighting 98% higher costs in Europe.[30] Both studies show that the main cost difference lies with high European sales costs (22% of total cost difference), followed by landing and enroute charges, ground expenses, and crew costs (Table 2.2).

Table 2.2 Comparison of 1981 European and US airline passenger service costs.[31]

Cost item	Local Europe (cents/km)	U.S. domestic trunk (cents/km)	European excess cost (cents/km)	European cost distribution (%)
Crew	0.99	0.47	0.52	11.2
Fuel	1.98	1.36	0.62	13.4
Maintenance	0.8	0.46	0.34	7.3
Depreciation	0.46	0.28	0.18	3.9
Route/landing	1.05	0.2	0.85	18.3
Station/ground	1.36	0.72	0.64	13.8
Passenger service	0.5	0.43	0.07	1.5

[29] Rigas Doganis, *The Airline Business in the 21st Century* (London: Routledge, 2005), p. 193.
[30] Association of European Airlines, *Comparison of Air Transport in Europe and the USA* (Brussels: Association of European Airlines, 1984), Table 2; UK Civil Aviation Authority data (1983), in Sean Barrett, *Deregulation and the Airline Business in Europe* (London: Routledge, 2009), Table 2.8, p. 13.
[31] UK Civil Aviation Authority data, represented in Sean Barrett, *Deregulation and the Airline Business in Europe* (London: Routledge, 2009), p. 13.

Sales	1.63	0.61	1.02	22
Other	0.58	0.18	0.4	8.6
Total	9.35	4.71	4.64	100

These high European sales costs are also determined by lower staff productivity, which are a symptom of overmanning. Indeed, labour productivity is another key piece of explaining the problematic outcomes that flag carriers were experiencing. Here too, data exists to compare the European to the U.S. and Canadian industry. In 1978, the average North American staff productivity was 52% greater compared to Europe when measured in tonne-kilometres per employee numbers.[32] The tonne-kilometres measure includes passenger and freight flown for one kilometre. Taken together with staff numbers, it is a measure of output. Even BA, Lufthansa, and AF (the best European performers) could only come close to between 82 to 91% of the labour productivity of North American carriers.[33]

The lack of competition on routes coupled with labour productivity issues and high operating costs led to costly fares. Because these fares were also subject to international agreements and discounted fares were not allowed, the situation was even more restrictive. Consequently, air fares within Europe were the highest in the world. The ICAO 1985 and 1990 surveys of international air fares exemplify the different outcomes. This research considers fares depending on route distances, ranging from 250, 500, 1000, 2000, and 4000 km. The 1985 ICAO survey highlights that European fares were 26% higher than the world average at 250 km routes, 18% higher at 500 km, 11% higher at 1000 km, and 4% higher at 2000 km.

However, at 4000 km these fares were comparatively similar with the world average owing to more strict international bilateral conditions on longer routes.[34] The European airline fare situation did not improve in the 1990 ICAO survey. Here, the data is expressed in terms of cents per kilometre flown.[35] The fare for a 250 km flight was 70 cents per kilometre in Europe compared to the world average of 45.1 cent per km, or nearly 50% higher in the case of Europe; 38.4 cents per kilometre compared to world average 28 cents per kilometre for a 1000 km route. For a 4000 km journey, the European airline fare was 21 cents per kilometre, still slightly above the 17.4 cents per kilometre world average.

[32] UK House of Lords, Select Committee on European Air Fares (London: UK Parliament, 1981), pp. 185-7.
[33] International Civil Aviation Organization, *Civil Aviation Statistics of the World 1984* (Montreal: ICAO, 1984).
[34] International Civil Aviation Organization, *Annual Survey of International Air Transport Fares and Rates 1985* (Montreal: ICAO, 1985).
[35] International Civil Aviation Organization, *Annual Survey of International Air Transport Fares and Rates 1990* (Montreal: ICAO, 1990).

Consequently, the evidence points to historically high fares experienced by the European airline industry due to restrictive practices.

The trio of high fares, high costs, low productivity led to a frequent bailout pattern, where the flag carrier experienced financial troubles only to be prompted by the government and taxpayers. For example, Alitalia had historically been an ailing flag carrier under the ownership of the Italian government. Throughout its history, only a few times has it encountered profitability. Yet, Alitalia was kept in a "comatose" state given its public utility function, as its former chairman Maurizio Prato confirmed.[36] This was done through capital injections worth billions of Euros from taxpayer money since its 1946 formation. In the 1970s, a troubled BA was requesting large sums of government funds to finance its planned operations and investment in new fleet.[37] While the BA example is not as dramatic as Alitalia, the UK government was also well aware that its loss-making flag carrier needed increasingly more funds to survive and operate.

There are many cases that have occurred outside of Europe as well, even after the 1980s. Air New Zealand was bankrupt after Ansett, the second New Zealander airline and Air New Zealand's acquisition collapsed, endangering the flag carrier. In the interest of the public, the New Zealand government stepped in to save Air New Zealand. Bailouts and government intervention to aid flag carriers were indeed common practice. Nonetheless, bailouts within the industry continue even after liberalisation. More recently, the example of the COVID-19 pandemic and its effects upon the industry have brought airline bailouts back into popular discussion. In many of these situations, flag carriers continue to benefit from their relationship with governments even after privatisation. This relationship often leads to a "too big to fail" type scenario similar to the financial world, where governments intervene to save flag carriers. This aspect is discussed throughout the following chapters with specific reference to the BA, Lufthansa, and AF examples. The COVID-19 pandemic has exposed the special government-flag carrier relationship.

However, these restrictions were gradually reduced as deregulation gathered pace. The following section highlights developments after the 1980s and the resulting contours of the industry in terms of LCCs, freight, and charter types of business models.

2.1.5 The liberalisation of civil aviation markets, 1980-2010

The period after 1980 would see the most international progress related to the liberalisation of the industry. These developments were built to some extent upon the progress made under

[36] Financial Times, *Chairman describes Alitalia as 'comatose'*, 26 September 2007.
[37] UK Ministerial Committee On Economic Strategy: Sub-Committee On Disposal Of Public Assets, 2 July 1979, CAB 134/4339, (Kew: The UK National Archives, 1979).

the Bermuda-type bilaterals. Yet, further liberalisation also came because of efforts from international organisations, such as the EEC, which realised the benefits of the Open Market competition and the eventual progress toward a shared and more harmonised common aviation market. Here, it can also be discerned how governance and ownership substantially change due to increased liberalisation in the sector. Because this international liberalisation progress has been achieved in stages even after 1980, the Open Market and Open Skies phases are discussed in this sub-section.

The Open Market phase of liberalisation is often considered the period encompassing the changes between 1980 and 1992. After the U.S. bilaterals, other countries in Europe followed in a similar way. For example, the UK and Netherlands were among the pioneering European nations to extend the more liberal bilaterals to each other in 1984, followed by other European nations during the 1980s, such as France and Greece.[38] Some of the more progressive bilateral clauses included free access to market for new carriers, access to any points between the two countries, and no controls on capacity. This increased drive for liberalisation in Europe would not go unnoticed by the EEC, which eventually took measures to facilitate deregulation within the intra-community setting. This was achieved through a series of legislative measures aimed to establish a common European air transport policy. There were three such air liberalisation packages.

The First Air Package was legislated in 1987 and kept the bilateral system in place. However, there would be no limitations on the number of airlines allowed to operate within the Community airspace. Capacity restrictions were also removed, and airlines were allowed to operate more *fifth freedom rights* than before.[39] The First Package permitted the entry of smaller airlines, such as British Midland and later to LCCs, including Ryanair. These smaller airlines were encouraged by the opportunity to compete on routes previously serviced only by specific designated flag carriers. As such, the rise of the LCC was facilitated by this legislation. The popularity of these new types of carriers would further be facilitated through the provisions of a second legislative act.

The Second Air Package was passed in 1990. It continued and added to the liberalisation trend set under the First Package in several ways: it permitted routes to most intra-community airports, further eased restrictions on multiple route designations, and allowed more price setting responsibility to airlines rather than governments.[40] In essence, these packages ensured that “Member States do not give undue preference to their "flag

[38] UK Parliament Hansard, Civil Aviation, Commons Chamber, Volume 64, 22 June 1984, cc. 596-658; UK Parliament Hansard, Civil Aviation Policy, Lords Chamber, Volume 453, 27 June 1984, cc. 932-67.
[39] Council Regulation (EEC) No 3975/87 of 14 December 1987 laying down the procedure for the application of the rules on competition to undertakings in the air transport sector.
[40] Council Regulation (EEC) No 2342/90 of 24 July 1990 on fares for scheduled air services.

carriers"".[41] The EEC also aimed to make it easier for airlines to operate new services on existing routes. This highlighted a substantial shift in balance and benefits of ownership.

The governments owning flag carriers now encountered more responsibilities to perform efficiently within more competitive and less regulated markets while simultaneously enjoying less economic advantages from operating them. This partly explains the start of the 1990s European airline privatisation movement and the shifting attitudes across the continent related to the challenges of governing and owning an airline. This is exemplified in Chapter 3 through the BA privatisation case. The UK government of the early 1980s was worried about the potential drain on government finances represented by the increased expenditure needed by the airline to finance its operations.[42] This was one such case of privatisation being motivated by the economic pressures of deregulation within the sector. This motive would come back in the case of several future airline privatisations, such as the 2022 Air India privatisation.[43]

The Third Air Package of 1992 allowed the European liberalisation drive to come full circle. Airlines would now have complete access to all routes between member states and the right to offer services between airports in two other states.[44] Air fares would also be freely decided by airlines under more stringent pricing protections to discourage predatory pricing. Governments were no longer allowed to discriminate between airlines seeking operating licenses within a territory without a reasonable excuse, such as safety standards. Rules were also relaxed related to the majority state or national ownership clauses previously featured in bilaterals, effectively allowing for more diverse and international ownership structures. The Third Air Package represented a culmination of liberalisation processes started and continued within the European space across the late 1980s-early 1990s. Importantly, these packages contributed toward the facilitation of the Open Skies period, the next noteworthy period in terms of deregulation. The pace for liberalisation was well underway in Europe and the U.S..

In Asia, however, there was no such coordinated response during the Open Market period. Rather, there were pockets of liberalisation and the measures were mainly related to the permission of other airlines to act as competitors to the state-owned carriers. For example, Japan allowed other airlines such as All Nippon Airways and Japan Air Systems to compete against Japan Airlines (JAL) on international routes in 1986, ending the

[41] European Transport Committee, Developments in European Community Air Transport Policy, HC 147, 18 December 1991, paragraphs 3-6.
[42] Nigel Lawson, Ministerial Committee On Economic Strategy: Sub-Committee On Disposal Of Public Assets, 2 July 1979, CAB 134/4339, (Kew: The UK National Archives, 1979).
[43] Financial Times, *Air India draws up privatisation plans*, 1 June 2017.
[44] Council Regulation (EEC) No 2407/92 of 23 July 1992 on licensing of air carriers.

monopoly of the national flag carrier. This was in preparation of the upcoming JAL privatisation. In 1987, JAL was fully privatised and subjected to competition without the backing of the government. As in the case of BA, here too the governance and ownership plans started to change since the late 1970s. Similar to the UK, the Japanese government understood the increased financial and managerial responsibility that owning an airline posed, especially within a decade of inevitable international liberalisation. A similar deregulation of domestic markets happened in South Korea and Hong Kong, where new airlines were allowed to compete in domestic markets.[45]

Since 1992, there has been further developments in terms of international civil aviation liberalisation. This period is called the Open Skies phase and should be perceived as an intensification of the liberalisation progress achieved under the Open Market phase.

In a similar manner to their action in the early 1980s, the U.S. identified the European openness to change and pushed liberalisation even further. This initiative also transpired because of increasing transatlantic demand. Once again, the U.S. decided to pursue this through a renegotiation of bilateral agreements. For example, one of the earliest and most important agreements of the Open Skies period was the U.S. and Netherlands 1992 bilateral.[46] The agreement included more liberalisation measures, including unlimited access on routes and traffic rights, no pricing controls, and code-sharing arrangements intended to expand market access and cross-airline commercial agreements. Besides these measures, the U.S. also enticed foreign airlines with anti-trust immunity for airlines which supported this type of bilateral. It meant that foreign airlines would be able to engage in commercial partnerships and agreements with their U.S. counterparts and set fares within their joint networks without barriers. This bilateral framework would later become as widespread as the popularity of the previous Bermuda-type bilaterals. It is estimated that the U.S. signed over 60 Open Skies agreements by 2007.[47]

However, Europe did not sit idly by. After the set of aviation packages facilitated the creation of a multilateral-type framework across the European airspace, the EU set their sights on creating a European Common Aviation Area (ECAA). The ECAA agreement was signed in 2006, effectively establishing a single aviation market within the European setting by integrating the EU neighbouring countries in South-East Europe, including the Balkan states, within the EU internal market.[48] This meant that airlines involved in this agreement would be allowed to fly unrestricted between ECAA member state airports, with the aim of

[45] Rigas Doganis, *Flying Off Course: Airline Economics and Marketing* (Routledge, 2010), p. 47.
[46] Washington Post, *U.S., Netherlands Agree To "Open Skies"*, 5 September 1992.
[47] Rigas Doganis, *Flying Off Course: Airline Economics and Marketing* (Routledge, 2010), p. 52.
[48] EU Commission, Communication from the Commission—Common aviation area with the Neighbouring Countries by 2010: progress report, COM/2008/0596 final, 2008.

a deeper integration and harmonisation of aviation practices across the continent. The liberal context of the European market further permitted the penetration of new LCCs, including Wizz Air and EasyJet, which took advantage of deregulation and the rise in demand for European leisure travel.

Access between important world regions was further achieved through the landmark signing of the U.S.-EU air transport agreement in 2007.[49] In essence, the agreement granted more *fifth freedom* rights, opening points to airlines, and increasing competition. For example, London Heathrow only permitted two U.S. carriers, United and American, and two UK airlines, BA and Virgin, to have transatlantic flight access. Under the new agreement, airlines like Delta were also allowed to operate and compete.[50] In 2009, the EU signed a similar agreement with Canada, aimed at linking the two markets and promoting competition.

Airline liberalisation has seen substantial progress in Asia as well during the Open Skies period. If the Open Market period in Asia was defined by more unequal geographical spread of airline deregulation, the Open Skies period would now witness more liberal bilaterals as well as select multilateral initiatives. Large markets like China and India opened access to more routes and renegotiated increasingly liberal bilaterals with the U.S. and UK since 2000 to allow for more airlines to operate between these countries. The result was also the rise of LCCs within the Asian region, including Air India Express and IndiGo.

Multilateral agreements have also been signed between Asian countries and other foreign regions. For example, several Pacific states, including Singapore and Mongolia, signed a multilateral deal mediated by the U.S. in 2001.[51] This agreement has facilitated increased access to the markets of the member states. Three years after, another multilateral agreement within the Asian region was announced. Ten members within the Southeast Asian region, including Philippines and Vietnam, planned gradual liberalisation between their countries, which is still currently underway. As in previous multilaterals, the aim has been to facilitate open access to routes, harmonisation of practices, and removal of barriers to entry for new airlines. The foundations for a Southeast Asian single aviation market are being built now.

Internationally, there has been a continuation and intensification of developments in governance and ownership changes. After the successful privatisations of several key

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[49] European Council: Decision of the Council and the Representatives of the Governments of the Member States of the European Union, meeting within the Council of 25 April 2007 on the signature and provisional application of the Air Transport Agreement between the European Community and its Member States, on the one hand, and the United States of America, on the other hand.
[50] Delta Air Lines, *Celebrating 10 years of operations at London Heathrow*, Retrieved from: https://news.delta.com/celebrating-10-years-operations-london-heathrow [Accessed on 16 January 2023].
[51] Multilateral Agreement on the Liberalization of International Air Transport (MALIAT), 2001.

airlines, including BA and JAL in the late 1980s, the Open Skies phase saw increasingly more airlines changing ownership. This became a substantial phenomenon during the 1990s, being aided by the increased liberalisation in the sector, but also because of international organisations like the EU or the IMF and World Bank. This is a notable point to make as former Communist countries underwent market transition during the 1990s with the help of the IMF and World Bank. These two institutions had a substantial part in shaping the agenda of Central and East European economies. Such measures included the privatisation of public utilities and other sectors, including airlines in exchange for development funds and expertise. Indeed, the governance and ownership changes within the airline sector extended beyond Europe to other economies. For example, the IMF has conditioned Kenya, Turkey, and Pakistan to sell their flag carriers as part of stability packages during the Open Skies phase. Nonetheless, there have also been other airline privatisations occurring in countries that embarked upon airline liberalisation without the help from an external organisation, such as the Western European ones. Indeed, the Open Skies phase has seen the most airline privatisations occurring at an international level.

These liberalisation developments also helped develop other industry business models. Beyond flag carriers, there have been LCCs, freight, and charter businesses. In this sense, the following paragraphs provide an overview of the contours of this industry to better understand how other participants have operated in this industry.

LCCs began operating their point-to-point business model as new routes became possible for these. New entrants like Ryanair, Wizz Air, easyJet appeared within the European space encouraged by the liberalisation pace. Unlike flag carriers, these LCCs have been operating a business model where traditional flag carrier services, including in-flight entertainment, catering, and lounge services are either absent or offered at additional costs beyond the base package. In this configuration, LCCs do not offer multiple passenger classes, like business class, premium economy, etc., unlike flag carriers.

As such, these LCCs have prioritised lower costs and services. The aim here is to offer low fares to mostly regional and secondary airports with reduced additional connections. These secondary airports are chosen due to the cheaper landing and departure expenses. Unlike flag carriers and their hub and spoke model, LCCs tend to operate at various secondary airports. In this sense, LCCs do not operate a hub and spoke model, where the hub is located at a specific airport. Instead, they have several operation bases. Since liberalisation, LCCs have also focused on providing leisure destinations within Europe as the Single Aviation Market became a reality. In contrast, flag carriers have historically catered to business travellers on medium to long-haul services, where a network has been developed.

In terms of operational model, LCCs favour a homogenous, single-type aircraft fleet, such as the Airbus A320 and Boeing 737. LCCs aim at low turnaround times and high aircraft utilisation rates and load factors. The homogenous fleet is due to maintenance cost reasons, although LCCs also tend to operate "younger" fleets due to more fuel-efficient operations.

The air freight or air cargo business does not operate similar to the air passenger business. Nonetheless, air cargo has also benefited from liberalisation in the sector by means of access to markets and relaxation of carrying capacity restrictions. Air cargo does not transport passengers as its main business model. Instead, air cargo services fly complex shipments of objects, equipment, machinery, products, etc. In this sense, the air cargo business must use and fit special aircraft to transport shipments of various volumetric shapes. Over time, air cargo services have mainly used wide-body aircraft like the Boeing 747, which in many cases have been repurposed from passenger operations to cargo flying services. Passenger amenities do not exist on this type of aircraft as a result. Because of the volume transported, air cargo services make economic sense to operate on medium to long-haul routes, where the costs of transportation become cheaper compared to naval and land cargo services. This is why air cargo tends to operate intercontinental services.

Just like passenger services, air cargo aircraft utilisation is essential. However, this is achieved differently for air cargo. Unlike passenger service, air cargo services operate stopovers where cargo is unloaded and new cargo is loaded for the next stage of the flight. This increases aircraft utilisation, but also means that the aircraft is able to transport more shipments compare to one non-stop direct flight.

This is why ground handling crews, including air service providers like the ones mentioned in Chapter 1 as socio-technical industry participants, are especially important to minimising stopover times. In the air cargo sector, the companies that also own and operate integrated services like door-to-door delivery, are the ones with the most market share success. In 2002, the four largest integrators, FedEx, UPS, DHL, and TNT accounted for 90% of the world's air express, door-to-door market.[52] FedEx and UPS operated their own air flights, whereas DHL and TNT employed the services of major airlines.[53] For example, airlines like Cathay also participate within the air cargo sector by providing transportation services for DHL on certain Asian routes, including Hong Kong.[54] In this sense, even the

[52] Anming Zhang and Yimin Zhang, "Issues on liberalization of air cargo services in international aviation", *Journal of Air Transport Management*, Vol. 8, Issue 5, September 2002, pp. 275-287.
[53] Anming Zhang and Yimin Zhang, "Issues on liberalization of air cargo services in international aviation", *Journal of Air Transport Management*.
[54] Anming Zhang and Yimin Zhang, "Issues on liberalization of air cargo services in international aviation", *Journal of Air Transport Management*.

main cargo integrators rely on the services of predominantly passenger carriers. This is because airlines can also transport cargo in the belly compartment of the passenger aircraft. In other aircraft configurations, such as the combi variant of aircraft, passengers can occupy the front section of the aircraft while cargo is situated in the back section behind a partition. Over time, flag carriers have also invested in combi-style aircraft to a certain extent, especially on routes where it makes economic sense to transport cargo as well, such as long-haul services that include intercontinental travel or polar routes. Nonetheless, the primary source of revenue for flag carriers continues to be from passenger services.

The air charter business also functions differently from the other two discussed here. Air charter carriers operate mainly a non-scheduled service as they depend on the flexibility and needs of their customers. In this sense, they can also be referred to as air taxis. Unlike flag carriers, charter carriers operate for a smaller and more select group of customers. These are usually business travellers, VIPs, company representatives, dignitaries, sports teams, etc. Rather than purchasing individual seats, these customers rent the entire aircraft for their trip, choosing who else will travel with them, as well as when and where the charter flight will take place. Because of this, there are no stopovers and routes are direct to destination. The amenities these customers receive are also tailor to their needs, in terms of catering and entertainment services. These passengers also avoid airport congestion as they undergo a separate special security check-in through private terminals or lounges, often administered by the chartered company.

Air charter carriers historically serviced regional and medium-haul destinations due to high operational costs and the restricted market entry and high fares regime. Since liberalisation and market entry deregulation, charter carriers now operate worldwide. Because of this and the tailored nature to fit customer needs, these charter carrier utilise smaller and more specialised aircraft manufacturers. These categories vary from the size of the aircraft to the operational range of it. For example, the Bombardier Challenger series of aircraft has been one of the most popular business jets since the 1980s due to its larger cabin, range, and lower maintenance costs. Indeed, Boeing and Airbus also have their own business divisions for charter aircraft production. However, there is more competition for Boeing and Airbus in the smaller aircraft manufacturers space than in the larger body aircraft one. Companies like Embraer, Gulfstream, Bombardier, and Dassault have offered competitive aircraft series like the Gulfstream G series and the Dassault Falcon series.

In this space, there are also a few noteworthy competitors that provide charter services. For example, NetJets is the market leader in this space, operating U.S., European, and Middle Eastern markets, with a fleet of over 700 aircraft. Flexjet also services the same markets as NetJets, although with smaller fleet of 200 aircraft. Here we see the absence of the traditional large flag carriers as these do not generally operate chartered flights unless under special circumstances, including political events and state visits. Unlike the flag carriers and their original national ownership, these charter providers are also privately owned. Nonetheless, governments and officials still employ their services in special circumstances. For example, Titan Airways, the UK air charter company operates flights for the UK Home Office and Foreign Office. Starting 2021, Titan Airways operated a new Airbus A321LR for the UK government, repainting the jet in the colours of the Union Flag.[55] Consequently, the air charter sector co-exists and complements the contour of the civil aviation industry.

Overall, the pace of liberalisation has often been unequal. The development of the aircraft and the early challenges associated with air sovereignty allowed for the implementation of airspace regulations before the Second World War. Yet, these regulations were challenged by countries such as the U.S., which stood to benefit from increased liberalisation. After several setbacks in achieving more deregulated air markets, progress gradually came under a negotiation of more liberal bilaterals after the Second World War. An increased drive for further liberalisation occurred after the 1980s, when organisations such as the EEC intervened to aid the process through the creation of a shared aviation market. During this period, the governance and ownership of airlines started to change owing to more financial and managerial responsibility within the context of increased international deregulation and competition. The pace for liberalisation has intensified since 1992 and within other regions of the world, such as Asia, which have also embraced multilateral agreements. During the Open Skies phase, the delegation of governance and ownership to private hands continued on a global scale, matching widespread liberalisation efforts in the sector. While the COVID-19 pandemic may temporarily halt further progress in terms of deregulation and privatisation, it is undeniable that the historical trend has been for more liberalisation. Because of this liberalisation, other business models, including LCCs, have developed their services.

In the upcoming section, the main airline privatisation developments are discussed as they have occurred over time, while governance and ownership changes are further addressed.

2.2 Trends in international airline privatisation

To better understand these developments in airline deregulation, the main trends in international airline privatisation must be considered. As previously noted, the governance

[55] Simple Flying news, *Brand New Titan Airbus A321neo Repainted for UK Government*, 22 March 2021.

and ownership of airlines have been closely linked with the major changes in liberalisation within the sector.

To a similar extent to deregulation progress, airline privatisation gradually began in the latter half of the 1980s. It has intensified after 1990s as more airlines and governments reoriented their interests and objectives to match market competition and liberalisation policies.

2.2.1 The beginnings of international airline privatisation, 1980-90

As explained, the early period of airline transport before the 1980s is best characterised by the predominance of state-owned airlines. ICAO has compiled a list along with data by region and airline privatisation date to highlight this aspect.[56]

Indeed, there were also private airlines, although these were often geographically more focused in specific markets which permitted this kind of governance and ownership structure. As previously highlighted, the U.S. is one such example. This was due to the specifics of the large domestic market, which was still regulated by a domestic civil aviation authority. These early characteristics of private governance and ownership were especially highlighted by the 1926 Air Commerce Act by which airmail services were contracted with private airlines. The U.S. government maintained their status quo of private governance and ownership within the sector. However, there were other patterns of ownership and governance originating outside U.S. borders.

These were located in Europe before airline privatisation had even started. Yet, these were uncommon. One of the earliest configurations of mixed ownership within the airline industry came from Scandinavia. In 1948, the governments of Denmark, Sweden, and Norway took half ownership of the newly established SAS consortium of flag carriers from each country.[57] The flag carrier represented the governments' shared interest in consolidating a Scandinavian service which could effectively compete against foreign airlines and provide stronger links between foreign territories and Scandinavian markets. Half of the SAS ownership was divided between the three governments and the other half was owned by private investors. The inclusion of private investors came as a result of the company's partially private origins. The Swedish airline which helped establish the consortium was first formed by a banker family. As a mixed ownership airline during a period of European protectionism and majority state-owned flag carriers, SAS is a

[56] ICAO, *List of Government-owned and Privatized Airlines*, (Montreal: ICAO Economic Development Internal Database), 2016.
[57] Scandinavian Airlines, History Milestones, Retrieved from: https://www.sasgroup.net/about-sas/sas-history/history-milestones [Accessed on 10 February 2023].

noteworthy example of airline ownership, strategic international governance, and one of cooperation. Nonetheless, the majority of SAS shares now belong to private investors.

Attention can be brought here to the alliance between the governance of the airline mainly by private investors and the strategic ownership between the governments. The dynamics between management and ownership is often discussed within scholarship and this relationship is also present in the case of airlines. For SAS, the relationship was cooperative during this early period as interests and management strategy coincided. This was also the case for BA, where the Thatcher government was often at odds with its aim of fostering competition to achieve a successful BA sale. The management led by John King also reminded Thatcher that it was in the government's best interest to support the flag carrier's managerial strategy.[58] This aspect is discussed in Chapter 3.

Another example is KLM. As an airline started by private individuals in 1919 and operated mainly under private ownership until the Second World War, it also represented a rarity among the other European flag carriers. The Dutch government wanted a controlling stake in the airline for strategic reasons, although the private owners only conceded a minority shareholding by the Second World War. In the early 1950s, this changed once KLM found itself in financial trouble due to necessity to acquire new jet-engine aircraft. The Dutch government stepped in and eventually acquired a majority ownership. Yet, these early examples highlight that there were still airline ownership structures which went against the state-owned trend.

The predominance of state-owned airlines, however, would gradually change in the latter half of the 1980s:

First, increased liberalisation in the sector brought about more airline competition and market discipline. This had several implications. On one hand, governments no longer had as much involvement in negotiating air fares, for example. On the other hand, governments were now left with managing airlines without other foreseeable benefits. Gradually, owning a flag carrier became a responsibility where the challenges outweighed the benefits. This dimension had implications for how governments relinquished the governance and ownership of their flag carriers. This was especially true in the context of a decade where economic changes, such as inflationary pressures, were widely felt and governments were looking for ways to tackle public borrowing, one example being the UK. The UK enforced public sector borrowing limits or ceilings during the early 1980s as a result.

[58] Robert Armstrong, UK Cabinet secretary, confidential letter to Margaret Thatcher, 3 October 1984, PREM 19/1412, (Kew: The UK National Archives, 1984).

Second, there was an important awareness of privatisation as a market discipline instrument developing within other sectors. For example, some public utilities such as energy, gas, and water authorities were already privatised in the earlier part of the 1980s.[59] These developments had already occurred in several countries by the time of the early airline privatisations. Laissez-faire economists highlighted (and often speculated) the benefits of privatisation, soon followed by civil aviation economists.[60] Western governments were often quick to endorse privatisation as a policy instrument because of these developments.

Third, some governments were quicker to adopt privatisation than others. However, this is also because of factors beyond the presupposed economic benefits from privatisation. The UK, for example, was ideologically committed to extending wider share-ownership through the sale of state-owned assets via the stock market. The establishment of a share-owning society was believed to be electorally advantageous. This was especially evident in the sale of BA, which was structured as to widen share-ownership.[61]

Fourth, international actors and organisations, such as the U.S. and the EEC took matters into their hands to push for increased liberalisation within the sector. As previously noted, the EEC pushed through legislation to facilitate a shared aviation market within Europe, while the U.S. was adamant about change through their bilateral clauses. Airline deregulation became increasingly accepted worldwide as countries and organisations pushed the responsibility of managing and setting tariffs from governments to airlines.

Last, restrictive bilateral and multilateral clauses related to ownership were relaxed. It meant that foreign investors could participate to a greater extent in the owning of shares within airlines. Increased competition during the Open Market phase alongside the increase in route designations and the rise of LCCs meant that different forms of inter-airline partnerships would be established to compete effectively. Partnerships, such as the 1993 partnership between KLM and the U.S. Northwest Airlines and the 1989 venture between Turkish Airlines and Lufthansa, would further highlight the dynamics of liberalisation. This point is returned to in the following sub-section.

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[59] There are many examples here to consider. For a study on telecommunication privatisation, see Andreas Kornelakis, "European market integration and the political economy of corporate adjustment: OTE and Telecom Italia, 1949–2009", *Business History*, Volume 57, Number 6, 2015, pp. 885-902; For a study on rail privatisation and franchising, see Robert Jupe and Warwick Funnell, "'A highly successful model'? The rail franchising business in Britain", *Business History*, Volume 59, Number 6, 2017, pp. 844-76.

[60] For example, the UK government was keen to use Michael Beesley and Stephen Littlechild, "Privatisation: Principles, Problems and Priorities", [1983], in *Privatisation and Regulation: The UK Experience*, eds. John Kay, Colin Mayer, and David Thompson, (Oxford: Clarendon Press, 1986) pp. 35-58. This study was perceived as a good basis for the UK programme of privatisation. For more on the policy-making process behind the UK experience, see Alan Walters, UK Chief Economic Advisor, private correspondence to Margaret Thatcher, 14 April 1983, THCR 1/15/5A Part 3, (Cambridge: Churchill College Archives, University of Cambridge, 1983).

[61] John Moore, letter to Margaret Thatcher, 20 October 1986, T 533/182, (Kew: The UK National Archives, 1986).

Despite these developments, change was not as swift as one may be inclined to believe. State-owned airlines continued their predominance. There would first need to be several important airline privatisation pioneers to help advertise the process. Singapore Airlines would become one of the first examples of the Open Market phase to undergo partial privatisation in 1985 and 1987. However, this was not a 100% full market sale.[62] The government continued to maintain a majority stake in its running given that the Singaporean government was cautious of liberalisation at this point in time.

In 1986, the Dutch government sold its majority stake in KLM, although it retained a minority ownership in case of hostile takeovers or other unforeseen threats to the flag carrier. The government's willingness to pursue more pronounced liberalisation should come as no surprise. Netherlands was one of the main European proponents of airline deregulation during this period.

In 1987, the world saw two of the earliest cases of full divesture from state-owned airlines: those of BA and JAL. BA was primed for full divesture since the early 1980s. The UK government was also committed to increased liberalisation in the airline sector, being a supporter of the Netherlands progress in this regard. Japan was also a leader in the Asian region given its flag carrier's full privatisation. Under Japanese law, JAL received single designation to operate international services. Once other operators, including All Nippon Airways, asked to compete in a context of increased international competition, the government endorsed this aim.

These two examples of full divesture were important cases for future airline privatisation as they highlighted that an IPO-style privatisation was achievable and absorbable by the stock markets. This was a principal issue which was still debated at the time as it was believed that airlines were harder to advertise and sell given their size. This is exemplified by the UK and BA case, along with other large companies. The concern was settled as the UK privatisation programme successfully sold large public utilities first.[63]

Other full-sale airline privatisations followed for the remainder of the 1980s. Examples include Air Canada and Air New Zealand in 1989 as well as Aeromexico in 1988. These privatisations were pursued as part of their domestic deregulation programmes aimed at promoting increased competition within the sector. As such, there is a dispersed geographical distribution evident here.

[62] ICAO, *Privatization*, ICAO Data and Figures Series (Montreal: ICAO, various years).
[63] Nigel Lawson, *The View from No. 11: Memoirs of a Tory Radical* (London: Bantam Press, 1992), p. 221.

2.2.2 The intensification of international airline privatisation, 1990-2022

Since 1990, there has been a worldwide intensification of airline privatisation. This has occurred due to the overall liberalisation measures implemented during the 1980s and early 1990s, but also due to many countries pursuing internal privatisation programmes under various objectives.

Airlines that started a partial privatisation in the 1980s would continue to sell more of the remainder of their ownership during the Open Skies phase. In several cases, governments were left with a minority shareholding or experienced a complete divesture from their flag carriers. For example, the respective governments owning shares within KLM and Lufthansa further divested until these airlines were either completely or close to being private. After several rounds of divesting in the 1980s and early 1990s, the German government achieved a full sale of Lufthansa in 1997 (Picture 2.3).

Picture 2.3 The Frankfurt futures and derivatives exchange market and the Lufthansa advert outside of the Terminbörse, 1997.[64]

In Asia, there was a more prominent shift in the airline ownership structure. China underwent a programme of liberalisation in several key sectors, including finance and technology, during the 1990s as part of their "open-door" policy. Airlines were also part of this. This drive was especially encouraged by the context of airline liberalisation within the sector. Major airlines, including China Southern, Hainan, and China Eastern Airlines have all had changes in their ownership structure since the 1990s. However, this has also been limited to an extent. The Chinese government has continued to be the majority owner of

[64] Lufthansa News, (Cologne: Lufthansa Archives, 1997), 13 October 1997. Made available to the public.

these airlines to this day due to security reasons, including hostile takeovers. Thai Airways has had a recent reduction in state involvement, with the government becoming a minority shareowner. This occurred after being under state ownership throughout most of the Open Skies period. Nonetheless, the Thai government continues to own nearly half of the airline. Malaysia Airlines, another legacy flag carrier, also underwent ownership changes in the 1990s. However, the more recent events surrounding its unprofitable operation and a series of tragedies involving the airline have reversed this. As a result, the Malaysian government nationalised the flag carrier in 2014 to save it from its demise.

A similar situation occurred after the 2008 Great Recession and the bailouts of several airlines. For example, the Japanese government also intervened to provide funds to JAL in 2010. However, JAL would keep its private ownership given that the indirect shareholding by the state fund was partial and very short-lived. In these cases, a strategic involvement of the state in the governance and ownership of airlines continues despite efforts for liberalisation.

These examples highlight that different ownership structures are not shielded from world events or unprofitability. This is an important case to make as other legacy carriers have suffered after privatisation as well as during nationalisation. As such, certain governments have renationalised then re-sold their airlines. The historically ailing Alitalia and its difficult relationship with the Italian government is one such case. Alitalia was privatised and renationalised on several accounts when the airline suffered losses.

More recently, the COVID-19 pandemic has brought about attention to this aspect. Certain governments, such as the German state and Lufthansa have intervened within their flag carriers to provide bailouts under certain conditions, such as partial renationalisation. Others, including the UK have decided against renationalising BA, opting to award government loans.

However, a phenomenon which is especially evident in Europe is distinguished. There continues to be a certain West-East divide in terms of the willingness to adopt airline privatisation. For example, there are majority or fully state-owned flag carriers, including the Polish LOT Airlines and the Romanian TAROM. While these governments do not specifically detail as to why their flag carriers are kept under state-ownership, there may be several explanations for this:

First, former Communist states have generally been slower to adopt market-oriented policies, especially related to privatisation. Chapter 1 highlighted that Romania experienced privatisation conditionalities imposed by international economic bodies, like the IMF. However, these conditions rarely include the privatisation of flag carriers, and they usually take years to implement.

Second, many of the Central and East European governments have had a history of using their flag carriers with more of a public utility function. This is especially true in smaller European countries where a single airline would usually serve the public interest and operate within small domestic markets. As such, governments may want to retain that vested interest in the future, especially in the context of uncertainty.

Third, the countries in the region have not been as ideologically committed toward overall liberalisation as Western countries. Instead, these countries have sought to maintain a certain general stake based on economic or security considerations.

Last, the flag carriers belonging to this region rely on government loans and help to a greater extent. This is because unlike the more well-established carriers, they mainly operate regionally and encounter increased competition from LCCs. As such, having the backing of the government in times of unprofitability acts as a safety net.

Overall, airline privatisation has seen important developments over time, affecting their governance and ownership. The start of airline privatisation and liberalisation during the 1980s has seen the first full divestures. In 1990s, other airlines across the world have followed privatisation, with some exceptions in the East.

2.3 Conclusions

This chapter has highlighted the principal industry dynamics before the 1980s, the main developments in civil airline market deregulation as they have occurred through time, and the main trends related to airline privatisation, governance, and ownership. The pace for liberalisation has often been unequal. There has been an increase in deregulation through bilaterals during the 1980-1992 Open Market phase and more multilateral-type agreements since 1992 during the Open Skies period. This development in deregulation has been possible due to the willingness of countries such as the U.S. and UK to engage in more liberal bilaterals which served as templates for other similar agreements, and later through international organisations, including the EU. Privatisation occurred within the sector as a by-product of deregulation and the change in government priorities and governance. In some cases, this was part of a wider ideological goal. The pace of privatisation has been impressive especially during the 1990s when most of the European major flag carriers were privatised. As the major actors within the European space, BA, Lufthansa, and AF have also seen important developments. Their ownership structures have changed over time to reflect the increased liberalisation drive. These three flag carriers have also dictated the direction of international civil aviation markets through the establishment of major alliances, including SkyTeam and Oneworld.

In the upcoming chapters, this study specifically considers how the three main European flag carriers have developed over this important period of privatisation and deregulation to better understand the principal processes of airline privatisation and the main changes that this industry has faced. The following chapter discusses the BA experience.

Chapter 3. British Airways

This chapter examines BA privatisation and the developments it has encountered as a result of privatisation and deregulation in the sector. The industry dynamics related to privatisation developments and the resulting industry changes are discussed. This chapter focuses on the timeframe between the 1970s to the year 2000. Nonetheless, it also touches upon the most important recent developments since, including the Iberia merger and the COVID-19 pandemic. The chapter is divided into three main sections, one each covering developments before, during, and since privatisation.

BA is a compelling case to consider as it is a prime example of one of the earliest legacy flag carriers to have experienced a full privatisation in the sector. Being at the forefront of the European airline privatisation drive, the BA case exemplifies the early industry dynamics developments within this sector and how these have changed during and after privatisation. The BA example is compelling for several reasons:

- BA is the very first full airline privatisation in Europe. Indeed, KLM was put up for sale in 1986 before the BA flotation by the Dutch government, although this was a partial rather than a complete divesture. A wave of airline privatisations followed after the BA sale and since the 1990s.

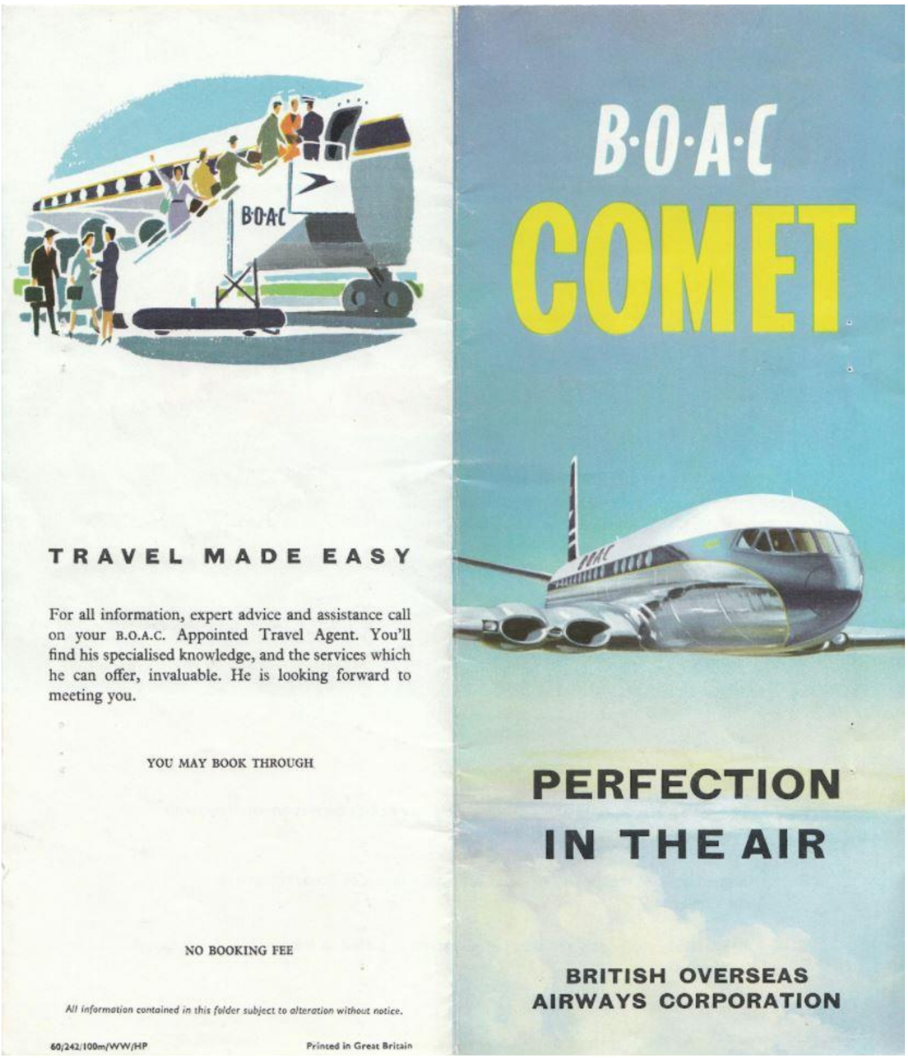
- The government has been involved with BA during nationalisation, privatisation, and since. This role has changed from direct to indirect intervention as a custodian role to support the BA strategy. The BA privatisation also involved what was ultimately an ideologically driven sale. While the UK government's early motives for the sale were of economic concerns as highlighted in this chapter, the latter part structured the flotation as to achieve wider share-ownership in the market.

- BA is one of the longest privatisations in-the-making in UK history. It took the UK government 8 years to accomplish, with official planning starting in 1979 and concluding with full divesture in 1987. As a result, the privatisation exemplifies the dynamic characteristics of privatisation in the sector. As highlighted in future chapters, other airline privatisations, such as AF, have also been structured over long periods of time because of various difficulties ranging from rationalisation to a change of governments and priorities.

- BA has been involved in the founding of the Oneworld alliance in 1999, one of the largest three airline alliances in the world. In this sense, BA has remained at the forefront of developments often being the initiator of progress within the sector as well as shaping industry dynamics. As noted in future chapters, Lufthansa and AF also share this initiator role when it comes to establishing alliances.

As a legacy carrier, BA is among the world's oldest flag carriers. Its origins are located in the formation of the state-owned BOAC (Picture 3.1) in 1940, which in turn was established from the merger of several previous British airlines, including Imperial Airways and British Airways Ltd., the latter of which was primarily concerned with air mail service in the late 1930s. The British government believed that the formation of BOAC would be better suited at serving national interests by linking colonial routes as well as establishing new ones across Europe. At the same time, the wartime effort meant that a pooling of aviation resources was necessary to better use aircraft for wartime purposes.

Picture 3.1 BOAC advertisement from the 1960s portraying the de Havilland Comet aircraft.[1]



In the immediate years following the Second World War, the UK government established two "sister" airlines to BOAC, BEA and British South American Airways (BSAA). This was done to accommodate various traffic demands: BOAC would continue to operate long-haul flights, while BEA focused on shorter routes. BOAC remained state-owned, although the other two started with mixed ownership with majority private investors until nationalisation in 1946, as part of the programme of the new Labour government. Following concerns over operations, the BSAA was then absorbed by the BOAC. BOAC and BEA, then, were the only main two state-owned British airlines left operating by the early 1950s. However, these would be kept as state-owned monopolies until well into the 1970s due to their strategic role for the transport infrastructure. Under new government proposals, the management boards of BOAC and BEA were brought together under a joint BA Board in 1972 created to oversee the operations of both. The move came as a result of

[1] British Overseas Airways Corporation, 1960s Comet advertisement, Credits: British Airways Archives. Made available to the public.

the government considering closer cooperation between the two airlines by harmonising the short and long-haul routes under what eventually became one flag carrier. This was done at recommendation from the 1969 Edwards Report, named after Sir Ronald Edwards the chairman of the Committee that explored the future of UK civil aviation, as a means of driving down costs, increasing customer satisfaction, and improving resource management. The foundations were, therefore, built for the eventual merger between the BOAC and BEA to occur in 1974.

The newly formed BA was established the same year, in 1974. Its status was that of a fully state-owned enterprise at the time of formation. The British flag carrier inherited the flight networks of its predecessors and was kept under state ownership throughout this period. However, its formation and early operations coincided with the 1970s oil crises, which raised government concerns related to its efficiency, profitability, and management.[2] In this sense, these concerns were already a reality even before the 1979 Margaret Thatcher Conservative government, a government which eventually took on the task of privatising BA. These aspects and the resulting outcomes are explored within the following section.

3.1 Developments before and during the privatisation process, 1974-84

This section discusses the changes at BA 10 years before privatisation. It focuses on the developments until 1984 to portray the context and issues during this early period in terms of inefficiency, motivation to privatise, restructuring, and steps toward flotation. BA experienced typical industry characteristics in terms of operational problems and outcomes, government intervention, and early motivation to privatise. This is specifically explored by considering the 3 years before and after flotation in the subsequent section to portray the developments during the sale.

3.1.1 The state of BA before the first Thatcher government, 1974-79

3.1.1.1 BA during the 1970s

Here, the context within which the newly formed BA operated under the Labour governments of the late 1970s is considered as well as ensuing problems. This is noteworthy to discuss as it represents the basis upon which the 1979 Conservative government decided to pursue the airline's privatisation. By the late 1970s and even before the start of Thatcher's

[2] John Nott, UK Secretary of State for Trade, *Privatisation of British Airways*, 1 October 1979, CAB 134/4339, (Kew: The UK National Archives, 1979).

first term in office, plans were already being drawn among the Conservative leadership to dispose of BA.[3]

The state of BA during the latter half of the 1970s was anything but enviable. Rather than experiencing a rebirth under the new merged BA brand, it encountered severe operational problems due to its ineffective management, but also due to the lack of operational autonomy given its ownership by and close relationship to the government.

The 1970s BA leadership is not spoken about or mentioned in detail even by the airline when recounting its official history. The first Chairman of the new BA was David Nicolson. Nicolson was appointed Chairman in 1971. However, he had no civil aviation experience, having been previously involved in the rubber industry a few years prior. Nonetheless, Nicolson oversaw the formation of BA.

Picture 3.2 David Nicolson, the first Chairman of the newly formed BA, pictured holding the Concorde supersonic aircraft model, 1973.[4]

After Nicolson left in 1975 to become the Chairman of Rothmans International, one of the major European tobacco products manufacturers, Francis McFadzean was appointed as the new Chairman in 1976. McFadzean was proposed by his friend Kenneth Keith, a board member on several important state companies, including Rolls-Royce and BA during the 1970s. Keith later chaired Rolls-Royce up to 1980.[5] Perhaps a more astute businessman than

[3] Nicholas Ridley, 1983-86 Secretary of State for Transport, *Final Report of the Nationalised Industries Policy Group*, 8 July 1977, THCR 2/6/1/37, (Cambridge: Churchill College Archives, University of Cambridge, 1977).
[4] Picture by Tony Marshall, Credits IMS Vintage Photos, 1973.
[5] Peter Pugh, *The Magic of a Name: The Rolls-Royce Story, Part 2: The Power Behind the Jets* (London: Icon Books, 2001), Chapter 10.

Nicolson, McFadzean had more than 10 years experience as a director at the Shell Petroleum Company.

However, it was clear that his focus and loyalties remained at Shell throughout his time at BA. McFadzean ran BA two days a week. This was done mostly from his office at Shell. He left BA in 1979 to become the new Rolls-Royce Chairman, after his friend and former Rolls-Royce Chairman Keith once again supported him. McFadzean left BA with a track record of losses and inefficiency, which embarrassingly earned BA the infamous appellative “Bloody Awful” among the British public.

The problems at BA during the 1970s can be summarised in the following way:

First, BA was experiencing operational inefficiency due to ineffective management. BA pilots were flying shorter hours relative to their European counterparts. As a result, BA had to pay its pilots and staff comparatively more for the hours flown, leading to higher operational costs on top of the high fuel costs due to the 1970s oil crises. These inefficiencies led to the use of more staff members and the operation of more aircraft. Issues at the airline were exacerbated by an uninspired decision to pursue an expansionary strategy in the context of a late 1970s recession.[6] This important diagnosis was found by internal BA and British Airline Pilot Association reports. Their summary is the following:

> The basic conclusion remains unchanged: namely, that BA pilots generally fly shorter hours; by contrast Continental pilots fly longer hours but also obtain longer leaves […]. [BA] has to pay relatively more than its competitors for the hours actually flown; it also has less flexibility in that it may need to use more men as well as more aircraft.[7]

Second, inefficient management and high operational costs resulted in overstaffing and labour productivity issues. As highlighted in Chapter 2, BA employees numbered close to 60,000 by the end of the 1970s. However, BA staff productivity on short haul under 350-mile routes was on average 25% of the top U.S. carriers in 1979.[8] This assessment is consistent with the industry wide comparisons between European and North American airlines presented in the previous chapter.

Last, this inefficient allocation of labour resources eventually led to internal disputes and to industrial action. For example, six disputes have been signalled between 1974-77,

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[6] John King, 1981-1993 BA Chairman, *The Lessons of Privatisation*, 18 June 1987, Archive Box N466, (Heathrow: British Airways Archives, 1987), pp. 9-10.

[7] British Airways and British Airline Pilot Association, *Report for BA and BALPA, April 1977*, AUJO Acc. 1273 Box 7, (Cambridge: Churchill College Archives, University of Cambridge, 1977), p. 9.

[8] Hansard, *British Airways' Future Strategy*, UK House of Lords, 6 November 1979, Vol. 402, cc. 785-806.

including those involving cabin crew, maintenance staff, and cargo.[9] A noteworthy case was in 1977, when 4,000 BA engineers took to industrial action to ask for improvements in shift allowances. This was due to the management causing scheduling issues.[10] The Conservative opposition was quick to blame these disputes both on ineffective management due to state-ownership and the susceptibility of BA and the government to union demands.

3.1.1.2 The BA-UK government relationship and operational issues

The flag carrier's relationship with the UK government also led to challenges in terms of its operational autonomy:

First, domestic cooperation between BA and British aerospace manufacturers like Rolls-Royce and British Aerospace was encouraged by the government for national interest reasons. The "Buy British" policy induced by the government was often not made on purely economic considerations for BA. For example, the Boeing 747 originally came fitted with Pratt and Whitney engines. However, BA and the government funded new 747 orders in the late 1970s that specifically came with Rolls-Royce engines as a means of establishing a closer link between Rolls-Royce and Boeing.[11]

Second, the UK government was heavily involved in the early 1970s Airbus and Concorde projects with France and Germany. Airbus was established in 1970 after years of previous development between the three countries. It is understandable why the UK government was effectively pressuring BA to acquire UK-produced and Airbus aircraft over U.S. manufacturers. There are several examples of this. During the early 1970s, the UK government pushed BA into acquiring the British-made Vickers VC10 and the BAC One-Eleven over the new and more fuel-efficient Boeing 737. The British government ended up subsidising the costs of this buying policy arguing that "to buy the 737 now would necessarily prevent our proceeding with one of the European options for a later requirement".[12] Indeed, this was not a new scenario for the UK government. In the 1960s, BEA was pressured to buy the British-made Hawker Siddeley Trident over the Boeing 727. In the late 1970s, BA was also considering putting in orders for the new 757, the 727 successor, over Airbus and BAC aircraft. BA had to fight extensively to justify their 757 orders much to the criticism of the government, which continued to insist that "[BA] must think and buy British and Anglo-European, by which means British Aerospace and British Airways will keep their rightful places as leaders of the world in their respective spheres".[13]

[9] Hansard, *British Airways (Disputes)*, UK House of Commons, 9 May 1977, Vol. 931, cc. 879-80.
[10] Hansard, *Heathrow (Dispute)*, UK House of Commons, 5 April 1977, Vol. 929, cc. 1105-9.
[11] Hansard, *British Airways' Future Strategy*.
[12] Hansard, *British Airways: Aircraft Purchases*, UK House of Lords, 8 May 1978, Vol. 391, cc. 759-76.
[13] Hansard, *British Airways: Aircraft Purchases*.

BA eventually stayed with the 757 orders after Rolls-Royce also became involved in producing the engines for the Boeing aircraft.[14] Nonetheless, the issues in operational autonomy are evident.

Another important example is the Concorde. As the second commercial supersonic airliner in existence after the Tupolev Tu-144, the Concorde was also a joint venture between France and the UK. The aircraft was introduced in 1976, with BA and AF each operating seven Concordes. As this was a strategic Anglo-French project the governments retained their involvement in the aircraft. The Concorde was expensive to operate, rarely being profitable. It was loud due to its sonic boom, and could therefore operate only over sparsely populated areas. Because of its construction, the aircraft was also of a limited carrying capacity. This was a burden put onto BA, which was already incurring losses in the late 1970s. In fact, the government was also helping BA by subsidising the costs until the early 1980s, when it decided not to support the Concorde anymore due to a track record of losses. The Concorde aircrafts were sold to BA at discounted rates in 1983. The Concorde was retired in 2003 due to high operational costs, expensive fares, and low passenger demand after the 2000 AF flight 4590 Paris to New York accident involving the aircraft. The depressed air traffic after the 2001 September 11 attacks also contributed to its demise. Nonetheless, the Concorde became a symbol of aviation history because of its supersonic technical achievements and expensive allure.

The BA case is an example of government intervention within the industry, often to the detriment of operational autonomy. As highlighted in Chapter 2, this was common at the time. The study shows in the subsequent chapters that the German government was also wary of Lufthansa’s buying policy, while AF was heavily invested in acquiring Airbus aircraft, becoming the principal Airbus owner within Europe.

All of the above issues led BA to a situation where the airline’s finances were heavily strained, necessitating large amounts of government funds to keep it operational. Table 3.1 highlights the BA actual borrowing and forecasted borrowing.

[14] Takeshi Sakade, “‘Riding Two Horses’: The British Aviation Industry’s Position Vis-à-Vis Boeing and Airbus Industrie”, *The Kyoto Economic Review*, Vol. 84, No. 1/2, 2015, pp. 29-45.

Table 3.1 Annual BA borrowing forecast according to the Sub-Committee on Disposals of Public Sector Assets and actual BA borrowing outcome.[15]

Year	Sub-Committee's BA borrowing forecast (£ million)	Actual BA borrowing outcome (£ million)
1977	195	195
1978	222	222
1979	348	348
1980	(forecast) 465	266
1981	(forecast) 462	234
1982	(forecast) 543	16
1983	(forecast) 595	−149
1984	N/A	−304

The first column of the table indicates the BA borrowing between 1977 to 1979, along with the forecasted borrowing requirements up to 1983 in the middle column. These forecasts were assessed by a committee comprising future UK Conservative Chancellors of the Exchequer Geoffrey Howe, Nigel Lawson, and Norman Lamont. In the last column of the table, the BA borrowing outcome up to 1984 is shown. This will come in very useful later in this chapter when the study discusses the BA miraculous recovery under new management.

BA borrowings increased over 1977-79 due to its high operational costs. Its future also looked grim. The Sub-Committee on Disposals of Public Sector Assets forecasted increased borrowing from the government up to 1983 because of the flag carrier's losses and as a result of future fleet replacement.

Importantly, the Conservative members who would eventually lead the country in 1979 also saw the unsatisfactory state of BA. They argued that BA was effectively "eating money" from the government.[16] The first proposals to privatise BA came in 1977, both from Conservative Party reports. The Ridley Report, named after Nicholas Ridley, the author and 1983-86 Transport Secretary during Thatcher's second government, is noteworthy. This report is the first to argue for a partial BA privatisation to "raise new capital" and reduce government expenditure.[17] The same year, another report from the Centre for Policy Studies,

[15] Data from Hoare Govett Limited, May 1987, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 63; J.G. Colman, advisor, confidential letter to John Moore, Secretary of State for Transport, 15 December 1986, T 533/182, (Kew: The UK National Archives, 1986); Department of Transport, *British Airways Sale Prospectus*, 1984, BT 245/1967, (Kew: The UK National Archives, 1984), p. 56; John Nott, Secretary of State for Trade, *Financing of British Airways – Share Issue*, memorandum to Sub-Committee On Disposals Of Public Sector Assets, 29 June 1979, CAB 134/4339, (Kew: The UK National Archives, 1979). Figures are not adjusted for inflation.
[16] Norman Tebbit, former Chairman of the Conservative Party, Personal Interview, Conducted on 19 April 2017 by telephone, Cambridge, Duration: 27 minutes.
[17] Nicholas Ridley, *Final Report of the Nationalised Industries Policy Group*, 8 July 1977, THCR 2/6/1/37, (Cambridge: Churchill College Archives, University of Cambridge, 1977), pp. 20-3.

the public policy think tank associated with the Conservative Party and co-founded by Thatcher, simply stated that BA should "become autonomous and self-financing".[18] This report does not expand upon future measures to be taken on how to achieve this. However, it encouraged further investigation into the matter of privatisation and industrial policy. These early reports were coming from the opposition rather than the late 1970s Labour government.

Nonetheless, the BA damning track record was excellently summarised in 1979 within the House of Parliament by John Wodehouse, Earl of Kimberley and Liberal Party spokesperson on aerospace matters:

> The object of the BOAC/BEA merger was to create a world airline through existing manpower and resources. It was to be more flexible and competitive, while simultaneously reducing wasteful duplicate administration. However, because of the entrenched attitude of key management, problems have arisen which have caused a marked decline of confidence in the upper echelon of management by those of more humble status, be they captains or cleaners […].
>
> British Airways is top-heavy in administration and over-manned by perhaps 7,000 or 10,000 in those areas the merger was supposed to reduce […]. The amorphous mass of British Airways administration remains much the same, and the only sufferer is the passenger through insufficient tarmac-level personnel, which means that the airline fails to meet its schedules.
>
> British Airways is desperately short of aircraft […]. Whatever British Airways may say, there has been an unbelievable lack of forward planning […]. British Airways has naturally denied that charge, but this lack of foresight means that British Airways has to react to events instead of anticipating them […].
>
> I believe that British Airways does more damage to British industry and our balance of payments deficit than any other company in the United Kingdom. For two decades it has actively pursued a policy of not buying British unless under Government persuasion.[19]

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[18] Centre for Policy Studies, *Industrial Policy Committee Minutes*, 9 June 1977, Alfred Sherman Papers (Sherman MSS), Royal Holloway, University of London Library, Box 13.
[19] Hansard, *British Airways' Future Strategy*, UK House of Lords, 6 November 1979, Vol. 402, cc. 785-806.

There were no steps taken by the Labour government or the opposition during this period to come up with concrete solutions to the BA problem. However, these issues were well understood by the end of the 1970s, giving the subsequent Conservative leadership the impetus for radical change in the industry by pursuing the full privatisation of BA. These developments are explored within the following sub-section.

3.1.2 BA privatisation steps during the first two Thatcher governments, 1979-84

3.1.2.1 Early privatisation preparations

In the same year that Thatcher took over leadership, the BA privatisation was already being planned. The new government took Ridley's late 1970s proposals for privatisation forward by the drafting of a Civil Aviation Bill.[20] This legislation highlighted the flag carrier's worsening situation and its need for increased borrowing. However, this went beyond Ridley's partial privatisation recommendations. A full airline privatisation, the first of its kind in Europe, was proposed instead. This decisiveness to fully privatise BA is also best explained by considering the following context:

First, the new Conservative government was faced with rising inflation in the wider economy. Under its Medium-Term Financial Strategy (MTFS), the government pursued a policy of limiting public borrowing. The government believed that addressing this issue was achievable through the control of the money supply and its largest credit counterpart—the Public Sector Borrowing Requirement (PSBR). Privatisation was perceived as a tool to effectively remove company borrowing from the PSBR. The MTFS and PSBR were indeed of concern when it came to the increasingly large borrowing forecasted for BA. The government argued that a full privatisation would remove the government's "obligations" to fund BA, concluding that it was clear "that BA should be outside the PSBR".[21] By 1980, legislation was introduced to limit BA borrowing powers as to not "exceed £1,000 million".[22] This step was especially important in a context where PSBR targets was constantly overshot (Table 3.2).

[20] John Nott, Secretary of State for Trade, *Financing of British Airways – Share Issue*, memorandum to Sub-Committee On Disposals Of Public Sector Assets, 29 June 1979, CAB 134/4339, (Kew: The UK National Archives, 1979).
[21] John Nott, Secretary of State for Trade, *Privatisation of British Airways*, 1 October 1979, CAB 134/4339, (Kew: The UK National Archives, 1979); Nigel Lawson, Financial Secretary to the Treasury, minutes of the Sub-Committee On Disposal Of Public Sector Assets meeting, 4 October 1979, CAB 134/4339, (Kew: The UK National Archives, 1979).
[22] 1980 Civil Aviation Act, UK Public General Acts, c. 60.

Table 3.2 Annual UK PSBR by ceilings and outcome.[23]

Year	PSBR ceilings (£ billion)	PSBR outcome (£ billion)
1979–1980	8.25	10
1980–1981	8.5	11.5
1981–1982	14.5	8.5
1982–1983	9.5	7.5
1983–1984	8	9.75
1984–1985	7.25	10
1985–1986	7	<6
1986–1987	7	4
1987–1988	4	−3
1988–1989	−3	−14
1989–1990	−14	−7

Consequently, BA was seen as a liability during the early 1980s and a prime candidate for privatisation and removal from the PSBR. As mentioned in Chapter 2, there were other examples of such as Air India and KLM, which were fully or partially privatised to alleviate government finances but also to finance the procurement of aircraft. Therefore, this practice has become commonplace within the industry.

Second, privatisation was also rooted within deregulation ideology for the Thatcher government, going beyond the economic quest to instil market discipline and address inefficiency. As part of this deregulation drive where the state was to transfer the managerial responsibility of industry to private hands, privatisation was deemed an instrument for the extension of share-ownership. The consolidation of a property-owning democracy was only possible through share-ownership.[24] This ideal was attractive to advertise for political and electoral reasons:

> Many find it difficult to grasp…economic concepts, but would have little difficulty…with the concept of ownership—it is something that people can understand, believe in, and vote for.[25]

This ideology was also in stark contrast to Labour and its nationalisation policies, where the state remained responsible for the running of these companies. Indeed, the share-ownership ideal was present at the onset of the UK privatisation programme. However,

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[23] Data from Geoffrey Howe, 1979-1983 Budgets, Hansard, House of Commons; Nigel Lawson, 1984-1989 Budgets, Hansard, House of Commons; John Major, 1990 Budget, 20 March 1990, Hansard, House of Commons.

[24] Geoffrey Howe, Keith Joseph, James Prior, and David Howell, *The Right Approach to the Economy*, 8 October 1977, THCR 2/6/1/216, (Cambridge: Churchill College Archives, University of Cambridge, 1977).

[25] Nigel Vinson, Centre for Policy Studies, letter to Margaret Thatcher, 11 June 1981, THCR 2/11/3/1 Part 2, (Cambridge: Churchill College Archives, University of Cambridge, 1981).

pressing economic matters like inflation took precedence early on in the privatisation programme, especially for the BA privatisation. Nonetheless, the share-ownership end goal was established early on. This would eventually prove decisive for the continuation of the BA sale during the latter half of the 1980s.

Last, international deregulation developments within the sector were already underway during the early 1980s. After the 1978 U.S. market deregulation and the Bermuda II agreements between the U.S. and UK, there was a growing realisation by the UK that increased competition and liberalisation would eventually define the sector. Rather than opposing change, the UK facilitated it. This is exemplified by the government's actions during the 1980s. As discussed in Chapter 2, the UK was one of the earliest proponents of liberal air service agreements in Europe. In 1985, the UK signed the first European agreement to allow for discounted fares and increased competition with the Netherlands. These early agreements became the model for the First EEC Liberalisation Package, which was introduced by the UK during its 1986 European Council presidency. The same year, UK-Ireland routes were deregulated, with traffic doubling between London-Dublin during 1986-88. The movement toward greater liberalisation was evident. In this sense, the responsibility of running a flag carrier within increased competition was best left to private ownership. Indeed, the Netherlands government also realised this early on when KLM was partially privatised in 1986. Nonetheless, more pronounced steps for route, pricing, and capacity deregulation would only come after the late 1980s as part of the EU single market formation.

With all of the above in mind, the government was prepared to hastily privatise BA in 1981. However, a recession and the weak state of BA meant that the context was unfavourable. The UK government was effectively stuck with financing BA, much to the displeasure of its members. The Labour opposition summarised it as:

> The Minister's tone was quieter than normal. That is appropriate, because he has had to eat some humble pie. The Government wish to increase BA's borrowing powers, because they have reluctantly had to announce that they will be unable to float the shares in 1981.[26]

Nonetheless, the government did not sit by idly. A new management was brought in with the aim of restructuring the flag carrier and preparing it for its eventual privatisation.

[26] John Smith, Shadow Secretary of State for Trade, quoted in *New Clause A*, 5 November 1980, Hansard, UK House of Commons, Vol. 991, cc. 1293-1307.

John King was instated as the new BA chairman in 1981.[27] Unlike Nicolson and McFadzean, King was more experienced in managing companies. His experience ranged from running engineering to vehicle manufacturing businesses and in 1970 to becoming the chair of Babcock, the aerospace and defence giant. However, he was also heavily vested in BA, having lobbied to run the company. By the early 1980s, King was already within the government's good graces, being presented as Thatcher's "favourite businessman".[28] King, however, accepted the chairman position with the condition that BA would become private.

3.1.2.2 A new BA chairman, rationalisation, and government support

The arrival of King and his rationalisation policies would exemplify an exercise in effective management, one that would become the standard in the industry as part of pre-privatisation planning. For example, AF, Iberia, KLM, and other major international flag carriers embarked upon rationalisation programmes in the run-up toward privatisation. Indeed, the BA rationalisation example received attention from airlines like AF, often comparing their experiences with that of BA. In 1988, the World Bank hailed BA as the example for airline privatisation techniques.[29]

This study shows the importance of managerial capability and lack of when examining Lufthansa and AF in the subsequent chapters. Nonetheless, it is utmost important to note that this effective management was supported by the government, through measures meant to advantage BA, including shielding it from competition and facilitating its monopoly power. This was done to ensure a successful and attractive flotation. In this sense, the government continued to be involved with BA.

King's rationalisation programme was extensive, decisive, and swift. It was also impressively successful. It addressed the following issues:

First, the route structure was revised with a focus toward improving long-haul service. This meant cutting unprofitable routes to focus on services that were promising in terms of demand. The transatlantic route to the U.S. and Canada was especially important for BA given its preferential treatment at Heathrow. Heathrow was also a publicly owned airport at the time. In this sense, take-off and landing slots were negotiated in favour of the national flag carrier. This aspect affected who could operate from strategic airports like Heathrow, forming an entry barrier to new competitors. BA also enjoyed a competitive

[27] Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it".
[28] Charles Moore, *Margaret Thatcher: The Authorized Biography, Volume Two* (London: Penguin Books, 2015), Chapter 7.
[29] World Bank, *Techniques of Privatization of State-Owned Enterprises, Volume 1: Methods and Implementation* (Washington D.C.: World Bank, 1988).

advantage on high-demand routes from Heathrow to New York and to Washington Dulles given the preferential bilateral agreements with the U.S. Due to the Bermuda II bilateral, BA took advantage of its monopoly position to increase presence and capacity on those routes in the context of restrictive allocation of routes. Its position was further consolidated when Laker Airways, a private British LCC and the second airline assigned under Bermuda II to service routes to New York, went bankrupt in 1982. Laker did not survive the early 1980s recession, although it was also put in difficulty because legacy carriers like BA and Pan American outcompeted it. Laker accused several legacy carriers of predatory pricing in an antitrust lawsuit, which was eventually settled out of court.

Second, overmanning, labour productivity, and staff loyalty were addressed. King reduced staff numbers from close to 60,000 to 36,000 by 1984. Impressively, this was achieved without union action because of the generous voluntary redundancy pay. BA bankers acknowledged that the airline was essentially "buying jobs out", spending £200 million to do so.[30] Two-year pay settlements were implemented to prevent disputes in the run-up to privatisation. In 1984, BA introduced very generous pension schemes compared to other nationalised industries. This new agreement ended index-linked pensions, allowing employees to negotiate more advantageous pensions.[31] This was done to incentivise worker loyalty for those remaining with BA.

Finally, a profit-sharing scheme linked to performance was introduced for the first time. These were major changes that would not have been undertaken if not for privatisation. Essentially, remaining employees were now incentivised to contribute more directly than before toward the performance of BA. Their status would change further closer to flotation, as shown in the following section. These steps were supported by the government in what scholarship terms "control by seduction" via incentives.[32] The government were swift to accommodate BA during this period as not to endanger its privatisation. Otherwise, it would risk political embarrassment.

Last, King embarked upon a fleet renewal programme in the early 1980s. The goal of this was to replace older aircraft and to structure a more homogenised fleet in preparation for future demands, but also for efficiency reasons. Older aircraft like the Boeing 707 and the Tristar were sold or leased out during recession. Starting 1983, the 757 was introduced to the fleet to service European and medium haul routes. The 747 remained the aircraft of

[30] Kleinwort Grieveson Securities, Investment Research: British Airways, January 1987, Archive Box N467, (Heathrow: British Airways Archives, 1987), p. 9.
[31] British Airways, *Annual Reports and Accounts 1984/1985*, BT 384/318, (Kew: The UK National Archives, 1985).
[32] Mike Reed, quoted in *British Airways: culture and structure*, Irena Grugulis and Adrian Wilkinson (Loughborough University Business School, 2001), p. 9.

choice to service transatlantic routes due to its capacity and fuel efficiency. BA opted for more 747 orders for 1986 to replace older models, thus effectively abandoning its former "Buy British" acquisition policy. A more homogeneous fleet was also desired as it was more cost-effective to service and operate. Furthermore, a more modern fleet means better fuel engine efficiency and improvements in carrying capacity, or load. As a result, BA had one of the "youngest" fleets averaging 7 years old compared to the IATA average of 10.3 years.[33] In 1983, BA fleet capacity recovered to rival European leaders Swissair and AF. By 1985, BA became the largest airline to carry passengers between the U.S. and UK as a result of taking advantage of its modern fleet and rising demand.[34] The fleet composition between 1981 and 1986 and its average aircraft age is summarised below in Table 3.3.

Table 3.3 BA fleet composition comparison and average aircraft age, 1981-86.[35]

Aircraft	Type	In Service 1981	In Service 1986	Average Age in Years (measured end 1986)
Tristar 1	Short-haul	6	6	12.1
Boeing 575	Short-haul	0	25	2.5
Boeing 737-200	Short-haul	25	45	5
BAC 1-11-500	Short-haul	21	21	16.4
BAC 1-11-400	Short-haul	5	6	19.4
HS 748	Short-haul	2	9	9.9
Trident 3	Short-haul	25	0	N/A
Trident 2	Short-haul	16	0	N/A
Trident 1	Short-haul	11	0	N/A
Viscount	Short-haul	8	0	N/A
Concorde	Long-haul	7	7	9.9
Boeing 747-100	Long-haul	16	16	14.7
Boeing 747-200	Long-haul	10	13	8.8
Boeing 747-Combi	Long-haul	0	2	11.6
Tristar 50	Long-haul	3	3	10.3

[33] Hoare Govett Limited, UK brokerage firm, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 50.
[34] James Capel and Co., security bankers, *British Airways*, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 5.
[35] Data from Scrimgeour Vickers & Co., *British Airways Airline Research*, January 1987, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 20. Please note that "BAC" stands for the British Aircraft Corporation manufacturer, while "HS" represents the Hawker Siddeley aircraft manufacturer.

Tristar 200	Long-haul	4	8	6.1
Tristar 500	Long-haul	6	2	4.5
Boeing 747 Freighter	Long-haul	1	0	N/A
Boeing 707	Long-haul	15	0	N/A

By the start of the second Thatcher government in 1983, BA was already operating within a "business structure shaped by the market-place" in preparation for its privatisation.[36] It was indeed common among other airline privatisations to experience rationalisation and the resulting managerial changes and cost reductions in the run-up toward flotation. This aspect is seen here with BA, and discussed in future chapters. Nonetheless, the government also helped BA maintain its monopoly power. Indeed, the role of the state cannot be understated in facilitating the protection of its flag carrier ahead of privatisation. This is common within the industry, and this happened particularly with the privatisations of AF, Aer Lingus, Lufthansa, etc. It is clear to understand why—similar to the UK example, governments do not want a failed privatisation that would endanger their political image and future industrial policy-making.

In the UK case, there are a few main examples where the government continued to advantage BA despite its rhetoric on facilitating competition:

In 1982, British Midland Airways (BMA) appealed to be awarded licensing to operate Heathrow to Glasgow and Edinburgh routes. This meant that it would compete with BA. The government, however, initially rejected this request after BA opposed the licensing of a competitor. The government argued that liberal licensing "might rebound to the disadvantage of wider liberalisation objectives".[37] After internal Conservative Party discussions and opposition from Thatcher's closest allies, including her confidant Ian Gow, as well as the realisation that BMA was unlikely to affect BA and its market share to a great extent, the decision was reversed.[38] Yet this early indecision on licensing signalled government reticence toward exposing BA to increased domestic competition.

The BMA example, however, was not a singular case. In 1984, the UK CAA, the domestic civil aviation regulatory body, argued that BA held a monopoly on domestic routes. It was stated that more competition should be introduced on the main routes by transferring routes to BCal, the designated "second force" carrier and main domestic competitor to BA,

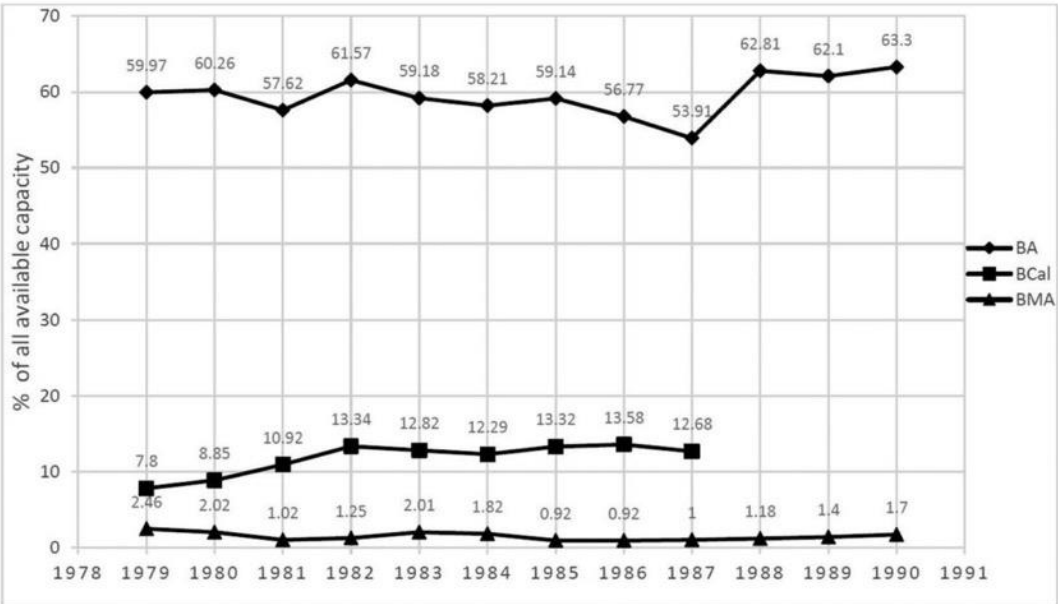
[36] James Lynch, *Airline Organization in the 1980s* (Basingstoke: Macmillan, 1984), pp. 51-3.
[37] Arthur Cockfield, Secretary of State for Trade, confidential letter to Margaret Thatcher, 23 July 1982, PREM 19/610, (Kew: The UK National Archives, 1982).
[38] Ian Gow, letter to Margaret Thatcher, 2 April 1982, THCR 2/1/4/107, (Cambridge: Churchill College Archives, University of Cambridge, 1982).

otherwise the government risked privatising BA as a monopoly.[39] Similar to the BMA example, however, the government understood the risks that introducing competition would have had on a successful privatisation, but also the implications of doing otherwise:

> There is a real dilemma: speed of privatisation, and simplicity, may speak in favour of leaving BA as it is, but the creation of a properly competitive market…favours a partial break-up sale before privatisation. The threat implied by a near-monopolist would be enough to inhibit competition.[40]

Once again, King pressured the government, warning that "even a small deviation from the present structure" would diminish BA size and performance, enabling other airlines to "grow at the expense of BA".[41] This claim was invalidated by the CAA, stating that BA would not suffer internationally as it would keep its Heathrow hub intact. The government ultimately rejected the CAA proposals, choosing route swaps over transfers. Because of this decision, there was no change in the size of BA between 1984-86 (Figure 3.1).

Figure 3.1 UK market share of selected UK airlines by annual percentage of all available capacity (passengers and cargo).[42]



[39] UK Civil Aviation Authority, *Summary of Main Conclusions and Recommendations*, in Nicholas Ridley, confidential letter to Cabinet, 1 October 1984, CAB 129/218, (Kew: The UK National Archives, 1984), p. 275.
[40] David Wolfson, Chief of Staff, letter to Margaret Thatcher, 15 November 1983, THCR 2/6/3/173, (Cambridge: Churchill College Archives, University of Cambridge, 1983).
[41] John King, 1981-93 BA Chairman, letter to Nicholas Ridley, 4 July 1984, AMEJ 2/1/125 File 2, (Cambridge: Churchill College Archives, University of Cambridge, 1984); John King, letter to Julian Amery, Conservative MP, 23 May 1984, AMEJ 2/1/124, (Cambridge: Churchill College Archives, University of Cambridge, 1984).
[42] UK Civil Aviation Authority (1983-90); the temporary BA decrease in domestic market capacity in 1986–87 is due to depressed international traffic as a result of the Chernobyl nuclear accident and the Libya bombings.

The outcome of managerial effectiveness and government protection resulted in a short but miraculous recovery for BA, spanning just 3 years:

First, the borrowing situation improved. This is highlighted above in Table 3.1. BA started borrowing less to the point that it repaid loans to the government. By 1984, BA was repaying over £300 million to the state because of its recovery and ability to finance itself (Table 3.1). In effect, it was transforming the PSBR to a Public Sector Debt Repayment (PSDR). The PSDR situation surprised the government, which previously forecasted large amounts of money. BA now became an asset rather than a liability to government finances, recovering from a £137 million net loss in 1980 to generating over £200 million net income in 1985.[43]

Second, its technical efficiency (TE) increased by an annual average of 2% by 1986, pulling ahead of the European average. TE is a performance indicator used to assess the efficient utilisation of inputs. A low TE airline uses more inputs to achieve output, indicating waste, whereas a high TE airline minimises waste utilising the fewest quantity of inputs per unit of output, indicating a more efficient airline. For example, a 60% TE airline would use 60% of its inputs efficiently to produce output. The rest of the 40% are wasted inputs. BA did not compare favourably to its competitors or the European average in the late 1970s. In fact, it was closer in efficiency to Alitalia, one of the worst-performing European airlines of the time. However, the recovery positioned it at the forefront of the European industry by 1984-85. This is represented below in Table 3.4.

Table 3.4 Annual technical efficiency of selected airlines.[44]

Year	BA	Air France	Lufthansa	Alitalia	European average
1979	62.8	65.6	66	59.2	64
1980	63.9	65.3	65.5	58.7	64
1981	65.1	64.9	65	58.2	64.1
1982	66.3	64.5	64.4	57.7	64.2
1983	67.5	64.2	64	57.2	64.2
1984	68.7	63.8	63.4	56.7	64.5
1985	70	63.5	63	56.3	64.6
1986	71.2	63.1	62.4	55.8	64.7

Last, this efficiency was reflected in the yield per passenger revenue. In 1980, the airline earned on average £3.7 revenue per passenger per mile flown. In 1984, this was nearly

[43] Figures not adjusted for inflation.
[44] Data from David Good, Ishaq Nadiri, Lars-Hendrik Röller, and Robin Sickles, "Efficiency and Productivity Growth Comparisons of European and U.S. Air Carriers: A First Look at the Data", *The Journal of Productivity Analysis*, Vol. 4, 1993, pp. 115-25.

doubled (Table 3.5). As the IATA price-setting limitations were still in effect during this period, these increases can be explained by efficiency improvements rather than fare hikes.

Table 3.5 Annual BA passenger yield per mile flown.[45]

Year	Passenger Yield (£)
1980	3.7
1981	4.2
1982	4.9
1983	5.6
1984	5.9
1985	5.8

By 1985, BA was in a very favourable position to be privatised. To celebrate its success, King rebranded the airline with the slogan "The World's Favourite Airline". With the PSBR and borrowing situation improving both in the wider economy and at BA, the government pushed ahead with the sale to achieve its aim of extending wider-share ownership.

3.2 The flotation and immediate post-privatisation period, 1984-90

In this section the study presents the 3 years before and after the BA flotation. It touches upon developments such as the structuring of the sale, the changing role of employees, the sale outcome, but also BA strategy and government presence immediately after privatisation given the context of increased deregulation within Europe.

3.2.1 Structuring the sale, 1984-87

3.2.1.1 Flotation steps and employees as share-owners

The government was well-positioned to take advantage of the BA recovery. The 1984 successful sale of British Telecommunications (BT) confirmed that large flotations were absorbable by markets. By 1985, the government announced an "irreversible shift in attitudes" due to demand for shares, promising to structure further sales as to offer 'the greatest incentives' to wider share-ownership.[46] This was also true for BA. The same year, BA privatisation advisers were given directives to structure the sale as "to widen share-

[45] Data from Scrimgeour Vickers & Co., *British Airways Airline Research*, January 1987, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 14.
[46] John Moore, "The Success of Privatisation" [1985], in Privatisation and Regulation: The UK Experience, eds. John Kay, Colin Mayer, and David Thompson (Oxford: Clarendon Press, 1986), p. 97.

ownership".[47] A flotation date was set for February 1987. The following measures were taken by the government to widen ownership and attract demand:

First, advisors decided for an IPO. The IPO method of selling shares was deemed most appropriate as it has the largest exposure to attract a wide range of investors, from individuals to consortia. IPO sales were indeed successful with the BT sale, attracting over 2 million initial shareholders, being 9 times over-subscribed.[48] But such a large IPO for a flag carrier was untested in Europe at the time. IPOs would become the standard method of future flag carrier flotations. This was in no small part due to the early success of BA, which proved that demand existed for large airline sales.

Second, the government deliberately under-priced the BA shares to stimulate demand and achieve wider-share ownership. The BA initial share-offer price was set at 125p, being among the lowest compared to flagship UK privatisations (Table 3.6).

Table 3.6 Selected UK privatisations by initial share-offer price, share over-subscription, and share premium.[49]

Company and privatisation Year	Initial share- offer price (p)	Over-subscription	Share premium (%)
Amersham (1982)	142	24.6	35
British Telecommunications (1984)	130	9	33
British Gas (1986)	135	4	9
British Airways (1987)	125	23	35
Rolls-Royce (1987)	170	9	34
Water Authorities (1989)	240	6	18

This was done to alleviate some uncertainty about floating a flag carrier as an IPO, which was novel at the time. Additionally, the government introduced other incentives to facilitate demand. A clawback mechanism was implemented to extend share-ownership by reallocating shares from institutions to individuals. After the clawback, nearly 20% of institutional shares were transferred to individuals, leaving the BA offer 23 times oversubscribed. Loyalty bonuses were also awarded. Shareholders who retained BA shares for three years received one free share for every ten to incentivise long-term retention.[50]

[47] Norman Lamont, Financial Secretary to the Treasury, letter to Baring Brothers and Co. merchant bank, 15 August 1986, T 537/85, (Kew: The UK National Archives, 1986); John Rhodes, BA privatisation advisor, letter to Norman Tebbit, Secretary of State for Trade and Industry, June 1985, BT 245/1967, (Kew: The UK National Archives, 1985).
[48] UK National Audit Office (NAO), *Department of Trade and Industry: sale of government shareholding in British Telecommunications Plc*, (London: House of Commons Papers, 1985).
[49] Data from *Privatisation*, Research Paper 14/61 (London: House of Commons Library, 2014), pp. 4, 8, 11, 23, 35, 42; NAO, Department of Trade and Industry, 1982-87.
[50] NAO, *Sale of government shareholding in British Airways Plc.*, 1987.

Last, the government encouraged domestic shareholding by allowing non-UK nationals to hold only up to 25% of BA shares. However, this was also done for industry regulatory reasons. BA still had to prove throughout the 1980s that it was majority domestic owned to maintain its favoured status as part of bilateral agreements. In this sense, foreign ownership was curtailed. Indeed, AF and Lufthansa also had checks on foreign ownership similar to BA for this exact reason.

Going beyond the steps of accommodating BA employees as part of the privatisation process, the government also facilitated employee share ownership within the airline. BA employees were offered incentives to buy shares. Each employee was offered free, discounted, and 2-for-1 government-matched shares. The interest in these shares among the workforce was profound. Shares were bought by 36,000 staff members, or 94% of the BA workforce.[51] Employees would hold 8.6% stake in the company to become share owners.

At the time, this was the largest share offer allocated to employees in a European flag carrier.[52] King praised this move as establishing "a more securely capitalist economy. It is promoting…a greater understanding of the nature of capitalism and a healthier attitude to the concept of profit and the creation of wealth".[53] King's assessment would have pleased Thatcher as it confirmed public endorsement of the share ownership and capital owning democracy she desired most.

Importantly, allocating shares and incentivising employees to buy these within the company they worked for fundamentally changed the role of BA staff. As previously seen, their former status as civil servants did not incentivise efficiency and performance. However, their new role as private employees and share owners meant that the government could uphold its wider share ownership ideology. At the same time, however, BA management could now secure the most direct link between the involvement of its employees and the performance of the airline. In this sense, the government believed that through privatisation both BA and its employees would become more responsible and attuned to a market discipline that was lacking before.

The involvement and consequent development of employee status to share-owners has since become an industry characteristic. This change was possible due to privatisation. This would become commonplace among future flag carrier privatisations, including Lufthansa and AF.

[51] British Airways News, 13 February 1987, Archive Box N465, (Heathrow: British Airways Archives, 1987).
[52] John King, *The Lessons of Privatisation*.
[53] John King, *The Lessons of Privatisation*.

It is also noteworthy to highlight the role of several parties when it comes to the structuring of the sale. Specifically, international consultancies have and continue to shape airline privatisations and the means of structuring and achieving flotation.

3.2.1.2 Cross-national consultancies and their privatisation involvement

There have been international actors involved in setting-up the sale, despite the focus on British markets. This means that international auditors, bank consortia, advisors, and underwriters with a transnational focus have taken part in the BA flotation and subsequent airline flotations.[54] These companies have used their BA structuring experience to advertise themselves to governments like Greece, Germany, France, Japan, etc. They have followed the above BA sale preparations and propagated them to other sales to the point of becoming airline industry flotation standards. As this study will show, this is the same for Lufthansa and AF. In this sense, the actions of these parties represent an industry dynamic of transnational cooperation. This has occurred through the process of privatisation and specifically at the pre-planning and flotation stages. Consultancies have been advising on various aspects, from IPO advertising to international share distribution and allocation.

There are a few noteworthy examples of important parties involved in legacy carrier privatisations. Hill Samuel and Kleinwort Benson were the main British banks overseeing the BA flotation. This meant that they advised on the structuring of the sale and the setting of the price offering. Lazard Brothers and Hoare Govett provided financial and brokerage advice to BA, while Rothschild served as the primary underwriter for the sale.[55] Because these financial institutions had a global reach, they would also advertise the sale in international markets, like the U.S. and Japan. For example, Nomura International acted as the lead manager of sales for BA in Japan, with Rothschild involved in the U.S. market.[56]

Their expertise with the BA flotation positioned these parties well to advertise themselves and acquire government contracts. Kleinwort Benson became the lead manager of the Lufthansa sale within the UK. Hoare Govett also provided brokerage support to the JAL and Lufthansa flotations. Nomura was also the lead manager of the Lufthansa sale in Japan. Rothschild also served as an advisor for the AF and the Greek flag carrier Olympic Airways sale.[57] These parties had an instrumental role in the structuring of the largest flag

[54] Dresdner Bank, list of privatisation consultancies, 13 June 1994, B126/146288, (Koblenz: Bundesarchiv); NAO, *Sale of government shareholding in British Airways Plc*., 1987.
[55] NAO, *Sale of government shareholding in British Airways Plc*., 1987.
[56] NAO, *Sale of government shareholding in British Airways Plc*., 1987.
[57] Memorandum to the German Ministry of Transport on the Second Tranche Offer for Sale, Deutsche Lufthansa, February 1994, Bundesarchiv B108/110689, (Koblenz: Bundesarchiv, 1994).

carrier flotations beyond the BA sale. In future chapters, the study highlights their involvement in Lufthansa, AF, and other airline privatisations.

Nonetheless, it is worth noting that the extent of consultancy involvement into these major flag carrier privatisations remains classified to a great extent, in no small part due to non-disclosure agreements between the parties. For example, the in-depth details and mechanisms by which these consultancies advise governments and flag carriers are less understood because of this existing confidentiality.

3.2.2 The flotation

On 11 February 1987, BA was finally privatised after years of preparations and recovery. The sale represents one of the very first major state-owned airlines to reach full divesture, and the first to do so in Europe.

Picture 3.3 Left-Right: Chairman King, Deputy Chairman of Hill Samuel bank David Bucks, BA CEO Colin Marshall, and BA Promotional Team member Isabella Edge celebrating the BA flotation, 1987.[58]

The BA flotation was popular, gathering 1.1 million initial shareholders, being over-subscribed 23 times and generating a highly profitable premium (Table 3.5). The sale proceeds reflected this success, generating £850 million.[59]

It compared favourably to other privatisations in terms of initial number of shareholders, although it was not as popular as the flagship privatisations of BT or British Gas, which brought in 2 and 4 million initial shareholders respectively. Nonetheless, BA was now a 100% private airline and the government celebrated achieving a successful flotation and its share-ownership aim.

[58] BA News, 13 February 1987.
[59] Figures not adjusted for inflation.

While the BA flotation preparations ensured that the sale would receive attention in the short-term, there were a few issues that would become evident in the longer-term. The government was wary that a sizable flotation could gather enough interest and demand in the market. To offset this and stimulate demand, the common tactic was to deliberately under-price the shares. However, the government excessively under-priced these BA shares. The excessive share under-pricing associated with the uncertainty of selling BA resulted in highly profitable aftermarket premiums. Therefore, BA experienced a pronounced drop in the number of initial shareholders after 1 year, from 1.1 million to 400,000. In effect, people were selling their shares at a profit as the incentives were not sufficient for long-term retention. By prioritising share discounts over longer-term bonuses, the government misjudged striking an effective balance to also stimulate BA share retention.

The UK Department of Transport acknowledged that it "did not commission market research to determine the need to offer bonus shares", underestimating market demand.[60] Shares were also predominantly concentrated within institutions rather than with individuals. Institutions, including bank consortia and societies, held over 36% of total shares.[61] The government later admitted that its aim of extending wider share-ownership was, "initially at least", achieved through the BA sale.[62] This issue was common among UK privatisations due to similar sale structuring efforts that prioritised short-term ownership. While overall shareholder numbers increased throughout the 1980s due to privatisation, this was insufficient to reverse the long-term decline in the proportion of shares held by individuals.[63]

Nonetheless, BA was now the first fully privatised European airline, while the government could enjoy the partial realisation of its wider ownership aim. The way forward in the 3 years immediately after privatisation and in the context of an increasingly deregulated industry posed interesting challenges for both BA and the UK government. These challenges would ultimately highlight that BA and British authorities continued their relationship even after privatisation, albeit in a more indirect and less interventionist manner.

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[60] NAO, Sale of government shareholding in British Airways Plc., 1987.
[61] Peter Morrell, *Airline Finance*, Fourth Edition (Aldershot: Ashgate Publishing, 2013), p. 167.
[62] NAO, Sale of government shareholding in British Airways Plc., 1987.
[63] UK Office for National Statistics, *Ownership of UK Quoted Shares: 2010*, p. 7.

3.2.3 The immediate post-privatisation period, 1987-90

3.2.3.1 Deregulation becomes a concern

With the successful full divesture of BA, the flag carrier was seemingly now on its own. Nonetheless, BA profitability and efficiency continued its upward trend in the 3 years immediately after privatisation, albeit at a slower pace compared to the more pronounced profitability experienced by BA during the privatisation process. For example, BA had a 3.4% annual average increase in total factor productivity (includes capital and labour productivity) between 1986-95 compared to an average 6% total factor productivity increase between 1982-86.[64] Consequently, BA continued its profitability, bringing in profits of £228 and £268 million in 1987 and 1988, respectively.[65] As a result, the flag carrier was able to embark upon a £1 billion aircraft acquisition programme starting 1988.[66]

While in a stable position immediately after the sale, BA would have to face the pressures of increasingly more deregulated international air markets. Several important changes started taking place during the late 1980s. These informed the future strategy of BA and eventually that of the European industry.

First, the U.S. deregulation of 1978 led to pronounced concentration of airlines in the North American market. Internal 1987 documents uncover BA anxiety related to the threat that these mega-carriers posed. King argued for the need to adopt new and radical measures to survive these "aggressive mega-carriers".[67] Indeed, post-Bermuda II agreements and the lobbying for liberalisation in the sector coming from several European countries, including the Benelux states, signalled that North Atlantic competition could only develop further in future years. In 1988, BA increased its routes to North America due to developing transatlantic demand (Picture 3.4).

[64] Peter Morrell, "The Role of Capital Productivity in British Airways' Financial Recovery", *Journal of Air Transportation World Wide*, Vol. 4, No. 2, 1999, pp. 84-99.
[65] Financial Times, 14 May 1988.
[66] Colin Marshall, BA CEO, letter to Julian Amery, 1962-64 Minister of Aviation, 21 October 1988, AMEJ 2/1/147, (Cambridge: Churchill College Archives, University of Cambridge).
[67] John King, and Adam Thomson, BCal Chairman, *Summary of the Joint Submission to the Office of Fair Trading and The Secretary of State*, 19 July 1987, AMEJ 2/1/143, (Cambridge: Churchill College Archives, University of Cambridge).

Picture 3.4 BA 1988 North American Routes.[68]

BA also exposed itself to increased competition as a result. As highlighted in Chapter 2, however, it was difficult to measure up to the size and scale economies of these American carriers without a new strategy.

Second, there were also important changes beginning to take place in Europe. A deregulation drive started with the 1987 First Liberalisation Package, followed by the Second Package in 1990. As discussed in Chapter 2, these EEC-backed packages gradually opened up the European markets to increased competition by allowing greater fifth freedom rights to airlines, relaxing capacity restrictions, and allowing airlines the ability to determine fares. Flag carriers were also no longer had agreement rights to service single designation routes within the Community. The end goal was the establishment of the Single Aviation Market, with the Third Package launched in 1992. The single market aim was thereafter complete once these measures took effect in 1997. Intra-Community bilateral agreements became a remnant of the past.

Between 1990-2013, intra-Community flights increased by 80% and number of routes increased by 138%.[69] The number of intra-EU routes with more than two carriers increased by 256% between 1992 and 2000.[70] Essentially, market discipline was being instilled within the European setting, with more competition taking shape after 1992. The extensive BA 1988 European route structure exposed it to future competition from rivals AF

[68] BA News, April 15, 1988.
[69] Organisation for Economic Co-operation and Development, *EU Air Transport Liberalisation Process, Impacts and Future Considerations*, Discussion Paper No. 2015-04, 2015, p. 11.
[70] ICAO, *European Experience Of Air Transport Liberalization*, (Montreal: ICAO, 2003).

and Lufthansa on popular routes between Heathrow and Paris as well as Frankfurt and Cologne (Picture 3.5).

Picture 3.5 BA 1988 European Routes.[71]

Last, privatisation effectively removed BA from the PSBR. In this case, BA could no longer access government borrowing to help fund its operations. After 1990, the EEC and later the EU also intervened to regulate state aid to prevent unfair competition among airlines. This erosion of the flag carrier connection to its government added further pressure for BA to find new solutions amidst upcoming competition. As the study will exemplify with Lufthansa and AF, these pressures and the resulting strategy would become common in the European industry.

3.2.3.2 Adopting the scale strategy and early post-privatisation investments

By 1987, BA saw its situation as an ultimatum given the deregulation of the European setting, the rise of transatlantic demand, but also due to its newfound fully private status. The new strategy was to become large and make use of economies of scale to offset competition and ensure survival. King saw this strategy in light of a dichotomy—"become very big or stay small, offering specialist services".[72] The choice was evident.

[71] BA News, April 15, 1988.
[72] King and Thomson, *Summary of the Joint Submission*, 19 July 1987, AMEJ 2/1/143.

BA moved quickly for a takeover of BCal in 1987. BCal was suffering losses partially as a result of the government's preferential route treatment of BA, but also due to its inability to withstand world shocks, including the 1986 Libya bombings and Chernobyl.

As opposed to BA, BCal's size was much smaller. In 1985, BCal represented 14.6% of total UK domestic passenger carrying capacity as opposed to 62.5% represented by BA.[73] BCal was also a private airline, meaning that there was no guaranteed access to government funds in case of insolvency. The takeover caused controversy as it effectively meant reducing domestic competition by dissolving Britain's second carrier. This was once again at odds with the rhetoric of the government to foster competition.

A 40% takeover bid from SAS was made public at the same time. Nonetheless, the government was against it, arguing the following:

> [It is] neither right nor conducive to fair competition between airlines in Britain that, the Government having earlier this year finally achieved the privatisation of the British airline industry, a major British airline should pass under control of an airline [SAS] in which three other governments have a predominant interest.[74]

Simultaneously, King repeatedly pressured the government to allow the BA-BCal merger to proceed:

> We [BA] must be big to survive.
>
> If we spend too long arguing a largely illusory issue of choice, we may wake up one day to find that we do indeed have a choice–to fly by a foreign airline or not fly at all.[75]

The BA-BCal merger was approved by the UK Monopolies and Mergers Commission, overseen by the government. It was finalised legally on 14 April 1988. BCal routes, aircraft, and staff were incorporated under BA. Consequently, BA increased its domestic monopoly power (Figure 3.1). April 1988 passenger revenue per kilometre also increased by 21% over the same month in 1987, while the fleet now numbered nearly 200 aircraft.[76]

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[73] James Capel and Co., security bankers, *British Airways*, Archive Box N465, (Heathrow: British Airways Archives, 1987), p. 6.
[74] Hansard, *BCal/SAS Negotiations*, UK House of Lords, 3 December 1987, Vol. 490, cc. 1138.
[75] BA News, 19 June and 24 July, 1987.
[76] BA News, 17 July, 1987; 20 May, 1988.

The press interpreted the government's response as "Crowning the King of Britain's airlines".[77] Privately, King received a written message from Julian Amery, the 1962-64 Minister of Aviation, congratulating him on a "great coup. The dogs will bark but let the caravan move on".[78] BA celebrated its achievement.

It is important to note that in this period immediately after privatisation, the government was still present, albeit more indirectly than before, to aid BA developments. A golden share in BA was still present until 1992. Immediately after privatisation, the government also supported the BA-BCal merger, opposing the bid from SAS. The government also cleared BA involvement in other future airline deals, including the 1989 BA-KLM stake in Sabena. In this sense, the relationship between the government and BA continued after privatisation, although under a different form. This study highlighted examples where European states became involved with their flag carriers during the post-privatisation period, although similar arrangements would also come true for Lufthansa and AF.

The focus to "become big" was soon followed by other steps during this period. These, however, were not as successful. BA sought to expand its influence by acquiring strategic stakes in other airlines, while at the same time achieve early partnerships with other large carriers.

In 1989, BA attempted to acquire 15% stake in the U.S. mega-carrier United. This was of strategic importance and one of the earliest attempts of BA to partner with a U.S. carrier. United had greater access to the U.S market, but also operated transatlantic destinations. It would have been a lucrative deal if not for the opposition from the U.S. Transportation Department. U.S. legislation allowed for 25% foreign ownership out of concerns of foreign takeover. As BA was interested in bringing more partners to this arrangement, the final stake would have been close to that threshold. This may have led to nationality clauses and ultimately bilateral agreement complications for United. BA left the negotiations as a result.[79]

The same year, BA redirected its attention to Europe to consolidate its position in the intra-community space, but also to develop its airport presence outside of Heathrow. This time, a partnership with KLM was on the table. BA and KLM both acquired a 20% share in Sabena, the Belgium flag carrier. This deal would have represented the largest European cross-national alliance at the time had it been successful. In this deal, BA would have been

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[77] BA News, 24 July, 1987.

[78] Julian Amery printed message to John King, 17 July 1987, AMEJ 2/1/143, (Cambridge: Churchill College Archives, University of Cambridge).

[79] New York Times, *British Air Ends Deal For UAL*, 20 October 1989.

well positioned to make use of Brussels as a European hub outside of Heathrow. The UK government was in favour of this arrangement, citing that the deal would not hurt public interest.[80] However, the EEC argued against the partnership on antitrust grounds. The EEC stated that a partial "takeover" of the Brussels hub by a select few airlines could lead to a stifling of competition. The deal fell through. BA and KLM re-sold their stakes to the Belgian government by 1991.

BA understood that on both sides of the Atlantic these types of investments and partnerships were still not possible at the time due to regulations. Despite these failures, however, BA continued its strategy. Furthermore, these failures informed the airline's partnership strategy in the 1990s, which would expand beyond strategic investments.

3.3 Post-privatisation strategy and the way forward, 1990-2000

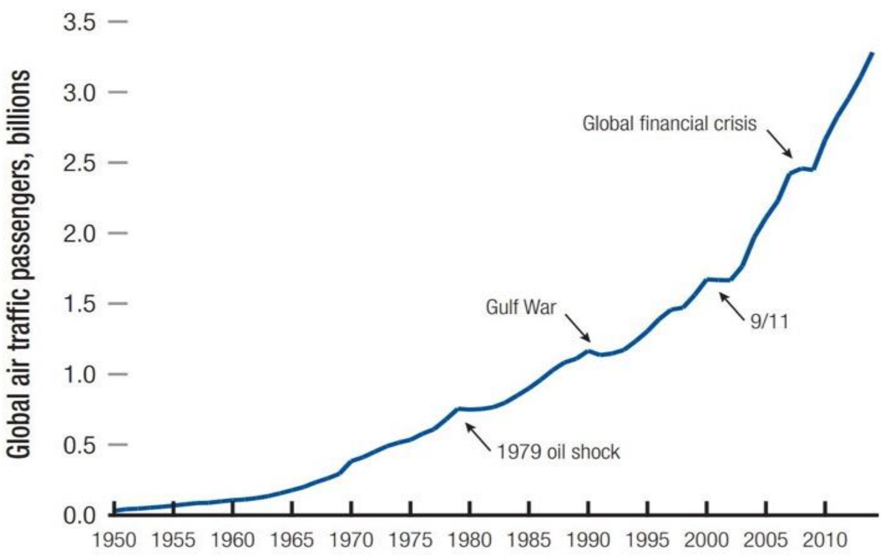
This section discusses how the scale strategy of BA continued to define this post-privatisation period, leading to strategic investment, the rush for alliances, and finally mergers. These steps have resulted from the increased competition of the European single market and the pressures of being a private airline. The BA strategy is that of developing from route to network linkages through alliances and cooperation. In this sense, competition, cooperation, and consolidation (termed the "3C's" framework in Chapter 1) became the *de facto* industry configuration. Concomitantly, the state assumes a new post-privatisation role as a custodian in helping BA achieve its strategy. In this sense, the state continues to have a role in relation to the private BA, and therefore the industry. The section concludes with an overview of the most recent developments at BA and the industry to confirm the continuity of these historic developments.

3.3.1 The strategic investments period, 1990-95

This period is characterised by an intensification of strategic investments into other airlines to connect BA routes and hubs to other European, American, and Australian hubs. However, the 1990s started with a new energy crisis occasioned by the 1990-91 First Gulf War conflict. As with other major energy crises, this led to a slump in traffic (Figure 3.2).

[80] New York Times, *Britain Approves Link with Sabena*, 26 July 1990.

Figure 3.2 Global air passenger traffic, 1950-2010.[81]



This was the first important energy crisis that the newly private BA experienced. As previously seen, BA did not fare well in the 1970s oil crises. Yet, the First Gulf War also affected BA and the industry, although disparately. North Atlantic traffic to London fell by one-quarter, with BA cutting flights from Washington due to lack of traffic.[82] Nonetheless, BA continued to benefit from its strong post-privatisation position to withstand the crisis. Others, including AF, Lufthansa, and KLM, imposed pay freezes and thousands of redundancies to offset losses. BA also cut 4,000 jobs, although it was the lowest redundancy figure out of the major European airlines.[83] BA was also financially stable throughout this period (Table 3.7).

Table 3.7 BA Operating profit and total assets, 1991-98.[84]

Year	Operating Profit (£ millions)	Total Assets (£ millions)	Operating Profit (as % of total assets)
1991	344.2	3,547.5	9.7
1992	310.3	4,503.9	6.9
1993	495.9	5,653.1	8.8
1994	659.5	6,730.5	9.8
1995	780.7	7,217.9	10.8
1996	596.6	7,276.5	8.2

[81] Graph from IATA, *Forecast for 2014*, (Montreal: IATA).
[82] Washington Post, *European Travel Industry Hard Hit*, 8 February 1991.
[83] Bernard Attali, 1988-93 Air France Chairman, address to employees, 17 December 1992, 697AP/170, Philippe Séguin Files, (Pierrefitte-sur-Seine: French National Archives).
[84] Data from UK CAA, *Financial Resources of Major UK Airlines*, (London: CAA, 1999). Figures not adjusted for inflation.

1997	216.2	8,479.3	2.5
1998	461.1	9,249.2	5

The First Gulf crisis had an important role in validating the BA strategy—the crisis exposed the weaknesses of uncompetitive carriers. BA realised that by focusing on scale it could withstand future crises and future-proof its operations. This was especially important in the context of its private status. However, BA also used its stable position to target strategic investments into airlines which could not withstand the outcome of the crisis, making them easier to take over.

BA embarked on a swift aggressive expansion on several fronts ahead of the single market deadline. Of particular importance to BA were investments in other airlines and take overs. The aim was to establish route linkages and expand the network both at home and abroad.

Domestically, BA took-over the debt-ridden British airline Dan-Air in 1992. Dan-Air was a private airline mainly operating charter flights, domestic UK services, and regional short-haul European routes out of Gatwick to destinations like West Berlin. Its small size, lack of operational focus, and a non-homogenous fleet contributed to the Dan-Air demise. After the Dan-Air takeover, BA consolidated its hold of the UK market by inheriting 12 short to medium-haul Boeing 737s from the airline. Importantly, BA established feeder services from Scotland, including a route from Inverness, to Gatwick. This route previously belonged to Dan-Air.

Feeder services are short-haul flights meant to connect to onward services such as long-haul flights. They are best seen as part of developing a route network of linked hubs. Feeder services were not new or specifically established for the post-1990 consolidation of the industry or the “3C’s” framework discussed in this study, although these have become more common and popular as tools of linking one’s network in the context of pronounced European deregulation and increased transatlantic demand.

Gatwick became a second hub to BA after Heathrow as it was the focus of these short-haul services. The government, now under a new leadership, once more approved the takeover despite criticism from upcoming domestic competitors, like Virgin.

Virgin, formed in 1984, was an upcoming competitor to BA by the early 1990s, especially on transatlantic routes. The government also allowed Virgin to operate at Heathrow starting 1991 after years spent at its Gatwick hub. The government abolished the London Air Traffic Distribution Rules in 1991, which previously obligated airlines without an internationally scheduled service at Heathrow to operate at Gatwick. This was done as to increase traffic at Gatwick and develop it as a hub. The early 1990s Virgin-BA rivalry was at the heart of the issue of BA take overs. Virgin accused the government of repeatedly siding with BA, citing the BCal merger and Sabena episode as evidence. Indeed, the government was well aware that it was supporting the BA strategy. Yet, it did not mind being accused of flag carrier favouritism. Rather, the government praised the BA tactic as British prowess and a privatisation success story.[85] There are more examples of government involvement to come.

In Europe, BA also invested in several other airlines to expand its route connections, gain access to hubs, and circumvent airport restrictions. The key word here is interconnection. In 1992, BA invested and eventually fully acquired Deutsche BA, a short-haul German feeder airline. The main reason for this move was to gain access to Munich airport and provide feeder services to Gatwick to develop Gatwick as a profitable second hub.

A few months later, BA acquired a 49.9% stake in the French airline TAT European Airlines, a smaller competitor to AF, with the option to further acquire a 50.1% stake by 1997. AF also had a 35% stake in TAT. AF eventually sold its stake in TAT on grounds that BA involvement circumvented Paris Orly airport slot restrictions. According to these restrictions, non-resident airlines had limitations imposed on the number of daily slots allowed to operate. With AF gone, BA completed the takeover of TAT in 1996. In 1997, BA acquired a majority stake in Air Liberté, another French airline with an Orly hub. BA would incorporate Air Liberté under TAT, consolidating its access to Orly. This BA strategy ensured that Orly and Lille were connected to Heathrow, with Marseille and Lyon linked to Gatwick.

Outside of Europe, BA focused on building alliances. BA acquired a 25% stake in the Australian flag carrier Qantas, as part of the Qantas first round of privatisation in 1993. Qantas looked for a strong ally in BA and further access to Heathrow, while BA looked to expand its influence to cover Australasian hubs. The 25% stake also fell within the legislated 35% foreign ownership limits. The Australian government was in favour of the deal, hailing the BA privatisation story and subsequent recovery as an "amazing one", although without specifically acknowledging the impressive rationalisation planning in the run-up toward the BA flotation.[86]

BA and Qantas began their cooperation on advertising, frequent flyer programmes, ground handling operations, and code-sharing. Indeed, the earliest frequent flyer programmes are traced back to United, Texas International, and American Airlines in the

[85] Hansard, Debate on European air transport liberalisation, UK House of Commons, 17 April 1996, Vol. 275, cc. 667.
[86] Australian Parliament, Qantas Sale Amendment Bill 1993, Second Reading.

late 1970s and early 1980s.[87] In this sense, these reward programmes were not new to the BA and Qantas cooperation agreement. However, unlike the early coupons-based passenger reward system that was specific to one airline company, these newer types of frequent flyer programmes were also aimed at combining and harmonising reward systems across partnered airlines.

Through code-sharing, both airlines agreed to sell seats on each other's flights. By 1995, the BA-Qantas Sydney-Heathrow route posed a competitive challenge to AF and Lufthansa, who reduced their services on this route. This early BA-Qantas partnership would become especially important a few years later with the establishment of the Oneworld alliance.

BA also acquired a 20% stake in USAir in 1993. USAir was ailing after the Gulf crisis. BA saw an opportunity to gain increased access to the U.S. market through the deal. The U.S. government and the main U.S. airline competitors were initially against the deal, arguing that it was essentially a takeover of an ailing carrier as a means to gain access to U.S. markets. In exchange of approving the alliance, the U.S. asked for access for its carriers within the British market. The UK government agreed to the concession to facilitate the BA alliance. Consequently, Bermuda II was revised in 1995 to allow for fare and route deregulation in the UK. U.S. airlines now had access to airports like Glasgow and Manchester, but also to other London-based airports like Stanstead and Luton. Meanwhile, BA and USAir started code-sharing and launched new routes, including the Gatwick to Pittsburgh service, which utilised a USAir Boeing 767 in BA livery and staffed by USAir crews in BA uniforms. BA also gained access to USAir hubs, including Philadelphia and Pittsburgh. Frequent flyer programmes and equipment sharing were other areas of cooperation.

As a result of these strategic investments to expand its route network, BA advertised itself as the first "truly global airline".[88] Indeed, BA was one of the earliest flag carriers in Europe to seize the opportunity for strategic investments in the context of the single European market deadline. However, this study shows that its competitors, especially AF and Lufthansa, did not sit by idly.

The government also lauded the BA strategy, continuing to show support and appreciation for the private flag carrier:

[87] William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition, p. 106.
[88] Interview with Colin Marshall, 1993-96 BA Chairman, Harvard Business Review, December 1995.

> [King and Marshall] set a standard for competitive achievement that is the envy of Europe and laid the foundation for British Airways' current position as a global force with strategic alliances in the Pacific basin through its stake in Qantas, in the Americas through its stake in USAir and in Europe through its stakes in TAT and Deutsche BA. It has also enjoyed a dominant pivotal position because of its primary location at Heathrow at the heart of Europe […].[89]

Indeed, King's strategy was successful by focusing on aggressive expansion. Yet, this would not have had continuity if not backed up by the new chairman. In 1993, King retired. After 12 years of service at BA, he was succeeded by Colin Marshall. Marshall served under King as the CEO since 1983, often credited as King's right-hand man. Marshall continued King's strategy throughout this period via adjacent investments meant to provide a seamless integration of operations.

First, Marshall focused on creating a BA with a "global scope but homey feel" by bringing together shared benefits across the different flying classes.[90] This included the access of passengers to departure and arrival lounges as part of the service, free access to facilities, including beverages and telephone services, and greater integration of services within the end product. Marshall contrasted this approach to the U.S. carriers, whom he accused of "undermining the integrity of their product" by charging extra for upgrades, including access to lounges.[91] Instead, BA developed its mission to retain customers by offering better integrated services as 35% of customers represented over 60% of its sales.[92]

Second, BA expanded and consolidated its services at Heathrow and Gatwick in 1994-95. Fast-track channels were developed in collaboration with the government to make it easier and faster for BA passengers to pass through immigration and customs. At the same time, BA renewed its operational lease for its Heathrow base for the next 150 years with the help of the government, further consolidating its hub.[93]

Third, BA expanded its operations to support businesses. In 1993, BA opened an in-house avionic engineering facility for aircraft maintenance, repairs, and components changes in Glamorgan, South Wales. Capable of operating more than double the engineering workload at Heathrow, the new base ensured faster turnaround times for maintenance. The same year, another maintenance facility was established in Cardiff, meant to complement the engineering capabilities of the Glamorgan base. Over time, other maintenance and

[89] Hansard, Debate on European air transport liberalisation.
[90] Interview with Colin Marshall, Harvard Business Review.
[91] Interview with Colin Marshall, Harvard Business Review.
[92] Interview with Colin Marshall, Harvard Business Review.
[93] Interview with Colin Marshall, Harvard Business Review.

engineering bases were opened at other UK hubs, including Glasgow. These were later also used by partners of BA, such as Iberia and American.[94]

Indeed, the King and Marshall strategy would continue after 1995, although under a new chairman. BA reaped the benefits of its investments and established further partnerships and code-sharing agreements. Importantly, the BA efforts led to the formation of the Oneworld alliance, one of the three largest airline alliances in the world.

3.3.2 Consolidation and the Oneworld alliance, 1996-2000

3.3.2.1 Code-sharing agreements

Marshall stepped back from his position in 1996, assuming a non-executive supporting role. Robert Ayling was promoted as the CEO. Ayling, who joined BA in 1985, worked as a legal director, marketing director, and group director throughout his time at the airline. The Ayling tenure is often regarded as an uninspired one: “First we had King, then we had Marshall, now we are just Ayling", as the media portrayed it.[95] Ayling pursued several controversial decisions, including a tailfin redesign with ethnic logos but without the Union flag, an uninspired attempt to cut cabin crew costs while still profitable to the anger of unions, and the formation of Go in 1998, an LCC airline, which ended up taking away from BA customers and cheapening the brand. Ayling left in 2000, while Go was later sold and the Union flag was brought back.

Nonetheless, there should also be focus on the achievements of this period, for a balanced perspective. And these were also noteworthy.

Ayling understood the value of extending cooperation through increased code-sharing agreements. In this sense, he was following in the steps of King and Marshall. The European industry was changing to pronounced competition as the single market was taking shape. Other airlines were following BA by pursuing a scale strategy, especially its rivals AF who were taking over its domestic competitors, but also investing widely.

European governments and the EEC pushed for more liberalisation through more airline privatisations and route deregulation. There were new entrants to market, including U.S. carriers, which have benefitted from having access to the UK market and beyond. LCCs like Ryanair and easyJet also started to expand in the late 1990s. In light of this intensified competition, Ayling continued to push for code-sharing agreements and cooperation. The main BA code-sharing agreements are presented in Table 3.8.

[94] British Airways website, *Explore our Past*, 1990-1999.
[95] The UK Guardian, *The man who fell to earth*, 11 March 2000.

Table 3.8 BA code-sharing agreements by airline, region, and purpose, 1996-99.[96]

Date	Airlines	Region	Code-sharing purpose
1996	America West	North America	Develop transatlantic services/ Open Gatwick-Phoenix route
1996	Canadian Airlines	North America	Frequent flyer programmes harmonisation/ Increase Calgary hub capacity
1997	American Airlines	North America	Extend transatlantic services/ Develop routes between Manchester and New York/ Develop routes between Manchester, Glasgow and Chicago
1997	Canadian Airlines	North America	New services from Heathrow to Toronto, Vancouver, Ottawa
1998	Finnair	Europe	Consolidate European market/ Increase capacity on Heathrow between Helsinki and Stockholm/ Frequent flyer programme harmonisation
1998	LOT Polish Airlines	Europe	Increase Central European capacity/ Increase flight frequency between Warsaw and Heathrow
1998	Malev	Europe	Increase presence in East Europe/ Code-sharing between Gatwick, Birmingham, Manchester and Budapest services/ Frequent flyer programme harmonisation
1999	JAL	Asia/Oceania	Increase presence in East Asia/ Develop Heathrow to Osaka route/ Frequent flyer programme harmonisation
1999	Iberia	Europe	Consolidate European market/ Develop services between Heathrow and Madrid, Barcelona/ Frequent flyer programme harmonisation
1999	Aer Lingus	Europe	Consolidate European market/ Develop services across the Irish Sea/ Frequent flyer programme harmonisation

96 British Airways website, *Explore our Past*, 1990-1999.

In 1996, BA started its code-sharing agreement with America West, opening the Gatwick-Phoenix route. The same year, BA and Canadian Airlines announced code-sharing and frequent flyer programmes, increasing capacity on routes to the Calgary hub. Cooperation deepened between BA and Canadian in 1997 and 1998, when code-sharing was expanded to routes from Toronto, Vancouver, and Ottawa to London Heathrow.

In 1997, BA and American Airlines announced code-sharing and the plans for deeper integration under the form of a future merger. This timing is best understood in context. Lufthansa had just announced the formation of Star Alliance, the world's first airline alliance the same year with 5 mega-carriers, including United. This pressured BA into seeking its own mega-carrier partnership. The BA announcement was controversial for several reasons.

First, BA essentially went against their USAir alliance to partner with American, one of the "Big Three" largest American carriers. USAir was angered by this and filed a lawsuit against BA, citing a breach of the alliance agreement. Ayling argued that it was "unwise to pursue an alliance with an unwilling partner", with BA eventually selling its USAir stake.[97] The lawsuit was eventually settled privately in 2000.

Second, the BA and American merger posed a competitive threat over transatlantic routes because of their access to airport slots. The U.S. argued that the two airlines accounted for 60% of passenger traffic between the U.S. and UK.[98] As a result, it encountered opposition from the EU and the U.S. government. These highlighted that the alliance would be approved if BA and American would have renounced nearly half of the transatlantic market share and over 300 Heathrow slots to rivals. The UK government, however, kept a more supportive tone on this matter, arguing that it "does accept that take-off and landing slots at Heathrow are in scarce supply but considers that it is for individual airlines to determine which routes should be served using the slots available".[99] However, BA could not afford to renounce many of its slots. The merger talks stalled and were ultimately shelved. The eventual compromise was an alliance similar to that of Star Alliance, which incorporated the BA code-sharing partners.

In 1998, BA pushed for more route integration through a series of code-sharing agreements with Finnair, LOT, and Malev. In 1999, Aer Lingus, JAL, and Iberia also joined BA code-sharing. With these strategic code-sharing partnerships, BA linked its routes to places like Scandinavia, Central and East Europe, and Asia. Ultimately, a network linkage was established which encompassed the world.

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[97] Robert Ayling, 1996-2000 BA CEO, in New York Times, 16 December 1996.

[98] U.S. Government Accountability Office, *International Aviation: Competition Issues in the U.S.-UK Market*, 4 June 1997, Report No. GAO/T-RCED-97-103.

[99] Hansard, *British Airways—American Airlines Proposed Merger*, UK House of Lords, 28 February 1997, Vol. 578.

Code-sharing led to increased cooperation among BA partners, being one of the defining methods of the BA strategy. Importantly, code-sharing established the building blocks upon which consolidation through alliances became possible.

3.3.2.2 The Oneworld alliance

The BA strategy of scale developed from code-sharing to the Oneworld alliance, from route to network linkages, and from cooperation to consolidation. It is fitting that this exemplifies the “3C’s” framework of the industry.

This study has shown how governments, including the UK and U.S., and the EU have aided with this development. For alliances to proceed, the EU and relevant governments had an important input. There was already the precedent set with the 1997 Star Alliance, which was allowed to be established as it served the whole European market. Yet the decision to allow alliances also resulted from a decade of liberalisation measures, from privatisation to the deregulation of the single market. Alliances represented the next logical step for the industry within a European space where airlines were already looking beyond route linkages.

There is nonetheless an outlier presented by European LCCs to the “3C’s” configuration. European LCCs do not participate in alliances. Neither are flag carriers welcoming of LCCs. This has happened for several reasons.

First, the no frills operational strategy has not been attuned to that of flag carriers, which offer a different type of service based on service quality and joint reward programmes. This makes the coordination of services and flyer programmes challenging if not impossible.

Second, flag carriers seldom desire association with LCCs due to branding and association reasons. Rather, flag carriers like BA may invest in LCCs (e.g. Deutsche BA) for feeder services.

Third, LCCs focus on short to medium-haul, point-to-point services with a standardised fleet to match this aim. LCCs also mainly operate at secondary airports (e.g. Paris Beauvais rather than Paris Charles de Gaulle). This does not fit with the scope of flag carriers.

Last, LCCs have generally not been interested in joining alliances. There are no European LCC alliances, because of their business model is focused on point-to-point services rather than the establishment of a hub-and-spoke network. However, a few LCCs like Ryanair and Norwegian have expressed interest in partnering, although nothing concrete has transpired.

For BA and other flag carriers, however, this configuration has led to the Oneworld alliance. After the failure of the BA-American merger, BA announced the Oneworld alliance in 1998 and officially launched in 1999 to rival Star Alliance. BA made use of its code-sharing agreements to establish closer cooperation with its partners. Oneworld comprised of 4 original partners, BA, American, Qantas, and Cathay. Finnair, Canadian, Iberia, LanChile, and Aer Lingus later joined by 2000 (Table 3.9).

Table 3.9 Oneworld alliance members, 1998-2000.

Date Joined	Airlines	Region	Ownership (at joining)
1998	British Airways	Europe	100% private
1998	American Airlines	North America	100% private
1998	Qantas	Oceania/Asia	100% private
1998	Cathay Pacific	Oceania/Asia	100% private
1999	Finnair	Europe	55% public
1999	Canadian Airlines	North America	100% private
1999	Iberia	Europe	50% private
2000	LanChile	South America	100% private
2000	Aer Lingus	Europe	85% public

The aim achieved through Oneworld was the linking of networks. In this sense, a global network was formed, linking the partner routes across the majority of continents. Deeper integration was also achieved through several measures. Beyond code-sharing and frequent flyer programmes, Oneworld partners offered joint services, including common lounges, priority boarding, joint advertising, baggage allowance and coordination, etc.

Later, Oneworld experienced the development of interlining cooperation. This meant that passenger itineraries and multiple connecting flights were simplified for Oneworld passengers. For example, baggage may be transferred onward to the end destination without having to be checked-in again for every connecting flight. For the airline, this is also beneficial as a means of maximising bookings as passengers desire a seamless service. At the same time, operational know-how and facilities have been shared between the partners. For example, the BA engineering facilities have also been made available for its alliance partners, while the different booking systems have later converged to one booking engine called the **business**flyer programme. Therefore, Oneworld partners have contributed to a deeper level of cross-national cooperation and integration.

Oneworld has been a success, becoming one of the top 3 largest alliances in terms of market share by passenger revenue and carrying capacity (Table 3.10).

Table 3.10 Major alliances market share and total market share, select years.[100]

Alliances	2000 (%)	2004 (%)	2006 (%)
Star Alliance (1997)	21.4	22	23.1
Oneworld (1999)	16.2	15	17
SkyTeam (2000)	10	19	18.7
Total	47.6	56	58.8

Importantly, Oneworld, alongside Star Alliance, and SkyTeam have contributed to the consolidation of this industry. The largest 3 alliances have accounted for more than half of total market share. This dominance has been kept since their formation. Nonetheless, competition is still ongoing between these alliances, with new partners joining after 2000, including carriers from regions like the Middle East and East Europe. Some, like Canadian, have joined and left, being acquired by competitors, including Air Canada. Because of the predominance of the "3C's" configuration, the future of BA and the European industry continues to be shaped by this consolidation.

3.3.3 The way forward, 2000-22

In this last sub-section, the study provides an overview of the main developments encountered by BA and the European industry since 2000. The industry has continued its developments, although it has abided by the scale and consolidation strategy. There are also several other challenges which BA has experienced.

3.3.3.1 Alliances and mergers continue

BA and Oneworld have continued to be at the forefront of the industry. Oneworld has expanded over time with new members joining each year to match the enlargement of its main competitors. Noteworthy members now include JAL (joined in 2007), Malaysia (joined in 2013) and Qatar (joined in 2013). However, airlines like Aer Lingus (left in 2007) and LanChile (left in 2020) have departed due to various reasons, ranging from change of strategy to acquisition by a competitor. In 2022, Oneworld comprised 13 members (Fiji is counted as an affiliate, yet still represented on the network map), encompassing the following network (Picture 3.6).

[100] Data from "Market Power and Vertical (Dis)integration? Airline Networks and Destination Development in the United States and Dubai", by Keith Debagge and Khaula Alkaabi, in *Aviation and Tourism: Implications for Leisure Travel*, Anne Graham, Andreas Papatheodorou, and Peter Forsyth (eds.) (Surrey: Ashgate Publishing, 2010), p. 156. Market shares based on revenue passenger kilometres and available seat miles.

Picture 3.6 Oneworld 2022 network map.[101]

Importantly, consolidation has continued beyond alliances. After the 2004 AF-KLM merger, BA began negotiations to merge with Qantas in 2008. While the UK government was in favour of the arrangement, the Australian government was worried that BA would essentially take over Qantas. Talks stalled and BA focused on Iberia as the merger candidate. Both BA and Iberia had been affected by the Great Recession. A new partnership was opportune. BA and Iberia agreed to the merger with the condition that both airlines operated under their brands. In 2011, BA and Iberia officialised the merger and the International Airlines Group (IAG) holding company was formed. Since then, IAG expanded by acquiring Aer Lingus in 2015, but also the LCC Vueling in 2013. The result has been a deeper cooperation on setting fares, matching networks, offering joint rewards, and pooling these rewards with Oneworld programmes.

3.3.3.2 LCCs start to bite

LCC have become a force to be reckoned on European short-haul routes due to their cheap fares. While not in LCC alliances, LCCs have learned strategies like providing additional services and bundling products (e.g. offering additional transportation facilities) compared to BA and other legacy carriers.

Nonetheless, legacy carriers have also adapted behaviour from LCCs to match competition and reduce unit costs. They have opted for unbundled services, including charging extra for amenities (e.g. charging for in-flight entertainment). In several cases, legacy carriers have invested and established LCCs to address competition. IAG bought

[101] Courtesy of Oneworld, 2022. Made available to public.

Vueling and founded Iberia Express as example. Lufthansa Group and Eurowings is another case. Feeder services continue to be delegated to LCCs in this relationship.

If the LCC inception of the latter half of the 1990s was negligible and concentrated among a few LCCs like Ryanair and easyJet, legacy carriers cannot afford to overlook them anymore. Wizz Air, Jet2, and Norwegian have been important upcomers. In some cases, LCCs have started code-sharing agreements with legacy carriers. For example, the Turkish LCC Pegasus has established code-sharing with KLM, ITA, and Qatar due to its favourable airport slots at Ankara and Istanbul. Going forward, it is likely that both LCCs and legacy carriers will continue to learn from each other.

It is, however, unlikely that BA, Oneworld, and IAG will have to worry anytime soon about LCCs alliances. There have been two LCC alliances operating since 2017, U-Fly and Value Alliance. These small alliances have been established in the Asia-Pacific region and operate there. However, their integration continues to be limited between members. For example, passengers must buy separate tickets and check-in separately with each airline. These two alliances also pose no threat to the top 3 due to their size and restricted network. Since then, European LCCs have not established LCC alliances. Other parts of the world have also not followed. It will be compelling to follow this development and understand to what extent the COVID-19 pandemic aftermath will result in LCCs pursuing deeper integration.

3.3.3.3 Crises expose the strategic importance of flag carriers and their connection to governments

After the Gulf crisis, 9/11, the Great Recession, and most recently the COVID-19 pandemic, there have been consolidation responses from BA in terms of investment, alliances, and eventual merger. Importantly, these crises and especially the COVID-19 pandemic have highlighted the strategic importance of flag carriers toward the overall transportation infrastructure. Governments have reacted accordingly by intervening to aid the industry and its flag carriers.

The UK government has awarded over £3 billion to BA in state-backed loans as aid for the pandemic. This has happened despite BA being a fully private airline since 1987. The government argued that BA has been particularly important to the UK transportation infrastructure as the country's only hub carrier, "providing critical connections" to the rest of the world.[102] The UK government did not acquire a BA stake in return, unlike AF and

[102] UK Export Finance, government body authorising external credit, in Travel Weekly magazine, 4 January 2021.

Lufthansa. Nonetheless, the strategic role of BA and other flag carriers is evident. While direct intervention as under nationalisation is no longer pursued for BA, this chapter has highlighted that the state has assumed a custodian role post-privatisation by supporting the BA scale strategy and safeguarding national interest.

Flag carriers like BA continue to enjoy a privileged position because of their strategic and historic connection to their government, despite ownership changes. Recent crises have exposed a "too big to fail" scenario similar to the banking sector where flag carriers have become strategically important as to not be allowed to collapse. This is why the phenomenon of large bailouts is present among the airline industry. BA and the UK government relationship exemplify this aspect. Subsequent chapters highlight that state aid has been instrumental for Lufthansa and AF in terms of achieving a successful privatisation, but also for surviving crises. It is likely the industry will see the continuation of this type of custodian relationship related to flag carries in the future.

3.4 Conclusions

This chapter has traced the processes underlying the BA privatisation, the first full divesture from a European flag carrier, as well as the resulting industry dynamics surrounding the privatisation and post-privatisation period, including deregulation and the "3C's"—competition, cooperation, and consolidation. Importantly, the following have been uncovered:

- In terms of industry dynamics related to the firm, BA exemplifies a flag carrier in the process of privatisation. BA underwent rationalisation procedures to cut costs and change operational strategy. In this case, it became more attuned to the exigencies of the market even since its privatisation planning. As part of this change, BA employees have a new status as share-owners rather than civil servants, participating more directly in the performance of BA. Since privatisation, BA has pursued a scale strategy through investments in other airlines and facilities, code-sharing, alliances and most recently mergers. Subsequent chapters reveal that the early BA privatisation and rationalisation planning has been followed by Lufthansa, AF, and other flag carriers within the sector, therefore becoming a standard practice within the industry.

- The BA strategy has shaped industry wide dynamics, BA has established cooperation with international partners in the Oneworld alliance and IAG. This has led to closer cooperation between partners and to the consolidation of the European industry under the "3C's" framework. Nonetheless, this has been possible by the deregulation movement that occurred in the sector after the 1980s, supported by the EEC and the UK government as well. This movement transpired due to the inefficient operations at BA and other major flag carriers, often leading to performance issues and state debt. In this sense, the pre-1980s industry dynamics led to the acceptance of privatisation and deregulation as instruments of correction.

- The state has had a crucial role during nationalisation, the privatisation process, and since. The ideology of extending share-ownership and gaining electoral support through the BA privatisation was also important in staging and continuing the privatisation. The role of the state has changed over time. It has developed its actions from direct intervention during nationalisation to a more indirect custodian role meant to facilitate the BA strategy. Some cases include actively shielding BA from competition during the privatisation process to allowing BA to expand through takeovers, investments, and alliances. Most recently, it has offered a bailout to BA during the COVID-19 pandemic. As such, the BA case exemplifies the evolving relationship of the government with a state-owned enterprise, thereafter with a private firm from the perspective of a flag carrier.

- There is a cross-national dimension discussed in this chapter that goes beyond alliance cooperation. International consultancies, bank consortia, and advisors have helped structure the BA flotation by processes of underwriting, sale management, brokerage support, etc. These have also opted for an IPO as flotation strategy. The same consultancies operated for Lufthansa, AF, and others, with IPO sales becoming the industry standard. This aspect is further discussed in subsequent chapters.

In the following chapter, the Lufthansa privatisation process is examined. Lufthansa has shared common aspects with BA by adopting similar strategies, but there have also been different privatisation characteristics between the two flag carriers.

Chapter 4. Lufthansa

The European airline privatisation story continues with the case of Lufthansa. Lufthansa, the German flag carrier, started its privatisation preparations in 1987, the same year BA achieved its full privatisation. The processes of privatisation behind Lufthansa are equally dynamic as with the BA case. Rather than opt for a quick and full sale in the style of BA, Lufthansa and the government took a gradual approach to privatisation for several reasons, including pressure from political parties, Lufthansa employees, and pension problems, all of which are brought to light in this chapter. This gradual approach meant that a full privatisation was finally achieved in 1997, although after several rounds of passive privatisation in 1987 and 1989 (involving government share dilution) and active privatisation in 1994 and 1997 (via government stake sales). As such, this chapter answers the same overarching questions presented in Chapter 1.

To maintain consistency with the BA chapter, this chapter traces developments 10 years before privatisation, during, and 10 years since privatisation. Consequently, the timeframe considered is between 1977 to 2007. More recent developments, including the formation of the Lufthansa Group and the COVID-19 bailout are also highlighted. The following aspects make Lufthansa a compelling case to consider:

- Lufthansa is the second largest European airline privatisation in chronological order. The BA flotation served as an example to Lufthansa and other airlines in terms of rationalisation, sale structuring, employing consultancies, employee participation, etc. Nonetheless, the Lufthansa case proves that there were still different characteristics to airline privatisation, especially when the move from partial to full divesture and from passive to active privatisation is considered.

- Lufthansa bucks the loss-making trend of the flag carrier syndrome. In one of the very few examples within Europe, the majority state-owned Lufthansa was profitable since the 1970s up to the 1991 Gulf crisis. As such, Lufthansa represents a profitable state-owned airline which underwent privatisation regardless of its status. This highlights a different aspect to airline privatisation and sale motivation, differing from that of BA.

- Lufthansa encountered unique challenges, ranging from political opposition to strategic demands, and the especially sensitive employee pension issues. These issues were close to derailing Lufthansa's privatisation. This explains the early gradual and often undecisive approach by the state.

- Just as in the BA case, the West German and later unified German governments were present in the privatisation process, but also have been serving as custodian roles since the full divesture. The government ultimately set the pace of privatisation, but also intervened to support Lufthansa in its strategy to compete effectively. Unlike the UK and French governments, the German government was reticent to endorse an ideological or even economic motive for the Lufthansa sale. Instead, it chose the practical third way of renouncing control of profitable candidates that were best run by private ownership within the context of increasing deregulation as well as operational and financial responsibilities.

- Lufthansa also fits within the "3C's" framework of the industry, like BA and AF. The Lufthansa privatisation process was gradual and slow. However, the fully private Lufthansa was quick to initiate partnerships, establishing the first multilateral airline alliance, Star Alliance. Later, it pursued mergers under the Lufthansa Group as response to the 2004 AF-KLM merger.

Lufthansa's origins are more controversial despite a similar merger start to that of BA and AF. In 1926, the Deutsche Aero Lloyd and Junkers Luftverkehr merged to form Deutsche Luft Hansa Aktiengesellschaft (DLH), the forerunner of the present-day Lufthansa. This occurred at the insistence of the German government, which effectively reorganised its aviation industry to only a select few airlines with the aim of re-establishing its industry and armed air military after the Great War. The state-owned DLH was the flag carrier of Germany throughout the Weimar Republic and Nazi Germany. As such, it was closely tied to the ruling parties. Therefore, the DLH has been accused of controversial dealings, including the use of slave labour and connections to Nazi officials.[1] The DLH was

[1] See Lutz Budrass, *Adler und Kranich. Die Lufthansa und ihre Geschichte, 1926-1955* (Munich: Karl Blessing Verlag, 2016). Budrass has accused present-day Lufthansa of sweeping these controversies as well as their

dissolved by the Allied forces after the conclusion of the Second World War. Yet, a new successor entity was established in 1953 as Luftag, bearing the name and brand of the DLH. The establishment of the second Lufthansa, and successor to the Luftag, was a coordinated effort between the federal government and the North-Rhine Westphalia state. The state-owned flag carrier officially started its operations in 1955. In East Germany, Interflug, the Lufthansa counterpart, began operating starting 1958, although with a Soviet fleet and under a communist government.

Lufthansa invested heavily during the 1960s in acquiring long-haul jet aircrafts such as the Boeing 707 in 1960 and 727 in 1964 to expand its network to new routes across the Atlantic and the East. The 707 became the world's most widely used jetliner of the time. This was during a period when Airbus aircraft were not present. Due to these new improvements in aircraft technology, it also oriented itself to new routes in Asia, including Hong Kong, Bangkok, and Tokyo in the early 1960s. As AF, Lufthansa was also swift to adopt the wide-body Boeing 747 starting 1970 and further expand its network, including to South America (Picture 4.1).

Picture 4.1 Lufthansa launches its first Boeing 747 flight from Frankfurt to New York in April 1970.[2]

history under the rug rather than come to terms. For another study which exposes the Nazi past of the German chemical conglomerate IG Farben, see Werner Abelshauser, Wolfgang von Hippel, Jeffrey Johnson, and Ray Stokes, *German Industry and Global Enterprise BASF: The History of a Company* (Cambridge University Press, 2003).

[2] Lufthansa News, 26 April 1970 (Cologne: Lufthansa Archives). Image made available to public.

Like BA and AF, Lufthansa remained predominantly under state ownership during this period. Yet, this was a variation of state-owned shareholding. Lufthansa was formed as an Aktiengesellschaft (AG), or a joint-stock company. The West German governments maintained a dynamic majority ownership of between 75%-80% from the 1960s to 1970s, although the minority share was offered to private participants, predominately banks, as traded stock. This arrangement was chosen to facilitate rounds of capital raising at Lufthansa. It was believed that the state should focus on its social rather than managerial responsibilities. As such, responsibility was devolved to the Lufthansa Board. Nonetheless, the state maintained its vested interest "to ensure the further expansion of the company independent of speculative interests".[3] This included keeping Lufthansa a German carrier. This view would come into play when the decision was taken to privatise Lufthansa.

4.1 Developments before privatisation, 1977-87

In this section the study discusses the state of Lufthansa 10 years before the start of privatisation. The focus is on the developments until 1982 to portray the context at Lufthansa during this early period in terms of operation, ownership, and motivation to privatise. The study notes that the 1982 Christian Democratic Union (CDU) government under Chancellor Helmut Kohl positioned Lufthansa as a candidate for privatisation. Yet this was met with opposition and controversy, as detailed here by political opposition, but also protests from Lufthansa staff. This opposition and surmounting challenges related to pension claims ultimately led to a passive and gradual form of privatisation starting 1987.

4.1.1 The state of Lufthansa before the first Chancellor Kohl cabinet, 1977-82

4.1.1.1 Operational outcomes

The state of Lufthansa contrasted with BA during this exact timeframe. There are several indicators within Table 4.1 revealing positive results at the German flag carrier.

[3] German Federal Ministry of Finance, *DLH Privatisation*, 23 October 1984, B126/143239, (Koblenz: Bundesarchiv).

Table 4.1 Lufthansa operating income, revenue, load factor, total employees, and employee productivity, 1977-87.[4]

Year	Operating Income (million DM)	Revenue (million DM)	Load Factor (%)	Total Employees	Employee Productivity (tonne-kilometres)
1977	75.7	4,561	59	27,677	173,100
1978	71.7	5,015	59	29,400	177,100
1979	92.2	5,128	63	29,838	180,900
1980	26.4	6,042	59	30,664	193,300
1981	68.7	7,073	60	30,696	192,200
1982	32.9	7,580	60	30,712	208,800
1983	279.9	8,208	61	31,575	217,900
1984	703.5	9,503	62	32,316	224,900
1985	152	9,802	62	34,905	231,100
1986	66.6	9,380	60	37,662	229,400
1987	84	9,831	67	39,540	245,800

First, Lufthansa remained profitable throughout this period while state-owned. In terms of operating income, which includes income after taxation, and revenue, Lufthansa maintained a consistent revenue stream and income. This reduced slightly in 1980 due to the late 1970s economic slowdown and high fuel prices, although recovered after 1982. In 1984, Lufthansa recorded its best fiscal year earnings since foundation.

Second, the load factor, or carrying capacity reduced slightly in 1980, but also recovered and remained constant thereafter. A 60% load factor reveals that 60% of its capacity was efficiently utilised to generate passenger revenue. The higher this percentage is, the more efficiently the airline utilises its capacity. The industry produces excessive capacity to accommodate possible demand, meaning that close to 100% load factors are unobtainable. This chapter recalls Table 3.4 from Chapter 3, which highlights technical efficiencies, a measure of assessing the efficiency of utilising inputs to create output. The Lufthansa TE between 1977 and 1982 outclassed BA and AF and remained above the European average.

Third, Lufthansa maintained a stable and productive workforce. It was not an overstaffed organisation of the likes of BA, which numbered nearly double as many employees. Importantly, the average employee productivity increased consistently in line

[4] German Federal Ministry of Finance, *Lufthansa Capital Increase*, 16 March 1987, B126/159616, (Koblenz: Bundesarchiv); Lufthansa Annual Reports 1985-89, (Cologne: Lufthansa Archives). “DM” stands for the Deutsche Mark currency. Figures not adjusted for inflation.

with the increases in total workforce. This metric measures the average traffic flown, expressed in tonnes per kilometre that is generated from each employee. This includes passengers and cargo. The higher the figure, the more revenue is generated from each employee.

Last, this favourable situation is reflected within the Lufthansa well-developed 1980 route structure and traffic statistics, expressed in Picture 4.2 and Table 4.2.

Picture 4.2 Lufthansa 1980 route map.[5]

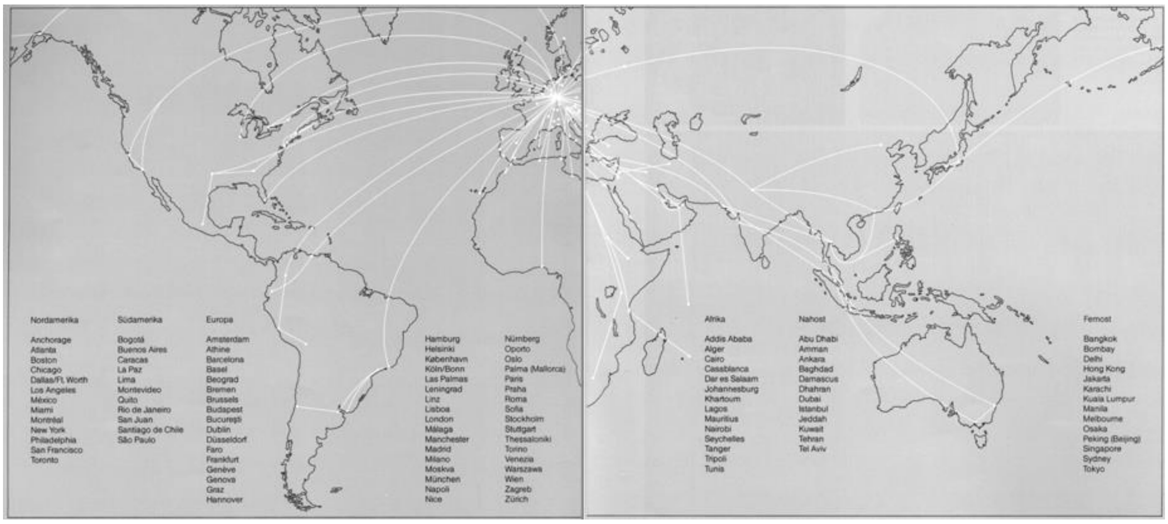

Table 4.2 European airlines by total passenger traffic (international and intra-European), 1981.[6]

Total Traffic

Scheduled Services

Passengers	(000)
1. British	15304.9
2. Iberia	13208.3
3. Lufthansa	**12964.4**
4. Air France	11565.0
5. SAS	8416.1
6. Alitalia	6985.4
7. Swissair	6220.8
8. Olympic	4901.0
9. KLM	3989.1
10. JAT	3271.2
11. Finnair	2674.9
12. THY	2071.3
13. Sabena	2050.8
14. Aer Lingus	1928.8
15. TAP	1914.9
16. BCAL	1911.6
17. Austrian	1358.1
18. UTA	987.5
19. Icelandair	499.7
20. Luxair	174.8

Here Lufthansa presence is noticeable across the main continents. With the quick adoption of the long-haul wide-body Boeing 747 in 1970 and the medium-haul Airbus A300 starting 1976, Lufthansa positioned itself well within both the European and transcontinental

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5 Lufthansa Annual Report 1980, (Cologne: Lufthansa Archives).

6 Unknown author, table from Der Lufthanseat, Lufthansa staff newspaper, August 1982, (Cologne: Lufthansa Archives), p. 6.

services. This allowed for more direct connections with fewer layovers. Destinations to Asia became an opportunity for Lufthansa than before. Consequently, Lufthansa was positioned among the top 3 European airlines in 1981 based on total international passenger traffic.

Overall, the picture here is that of a capable airline, which not only survived the 1970s crises, but did so without any meaningful losses. For a state-owned carrier, this was indeed impressive.

4.1.1.2 Leadership and strategy

These outcomes occurred under the leadership of Herbert Culmann and Heinz Ruhnau, the 1972-82 and 1982-91 Lufthansa chairmen, respectively (Picture 4.3). Unlike the early BA management who had limited experience with the industry and BA, Culmann had a long-standing experience with Lufthansa, while Ruhnau learned its specifics as the Transport state secretary and Lufthansa board member.

Picture 4.3 Lufthansa chairmen Herbert Culmann (left, 1972-82) and successor Heinz Ruhnau (right, 1982-91).[7]

Culmann had early ties to aviation. He served in the Navy and the Air Force during the Second World War as a pilot, although continued his presence within the sector thereafter by joining the Luftag in 1953. Using his doctorate in law, Culmann continued into the newly formed Lufthansa as the legal operations chief. In 1964, Culmann was selected as one of the four members of the Lufthansa board. After showing aptitude in administration and finance,

[7] Image credit and copyright by Wolf Prange, photo taken on 27 May 1982, Cologne. Image made available by IMS Vintage Photos.

Culmann was voted as the new chairman in 1970.[8] Culmann's experience of rising through the ranks from the beginnings of Lufthansa prepared him for a respectably long tenure. As chairman, Culmann embarked on a fleet renewal programme, meant to streamline the fleet into more fuel-efficient aircraft like the Airbus 300 and later the 310. The focus was on offsetting the high fuel prices of the 1970s with more fuel-efficient aircraft. Especially important was Lufthansa's use of Airbus aircraft and strategic preference over Boeing aircraft which started developing during this period. This study returns to this aspect later as an important factor in the privatisation decision.

In 1982, Culmann retired and Ruhnau took over. Unlike Culmann, Ruhnau had no early ties to aviation. Rather, he worked as a metal worker, later becoming involved with the district management of the Hamburg IG Metall. He continued as a trade unionist and joined the Social Democratic Party (SPD), where he rose through the ranks to member of the Hamburg State Parliament. Between 1974-82, he became the SPD Transport state secretary.[9] Due to this role, Ruhnau became involved with Lufthansa management as a member of the airline's supervisory board. By 1982, Ruhnau was accustomed to the operations of Lufthansa. Ruhnau's appointment was an interesting case. He was an SPD member elected by the Lufthansa board as chairman just as a new CDU Kohl cabinet came to power. Yet the state did not replace Ruhnau despite its history with the rival SPD. In this sense there was less state involvement at the management level of Lufthansa than at BA during this period, also in part due to the organisation of Lufthansa as an AG. What followed was an expansion strategy. Ruhnau developed Lufthansa's route services to Asia. Later in the 1980s, Ruhnau was concerned about the start of the deregulation drive in Europe and the impending single market establishment. As a result, Lufthansa embarked upon a fleet acquisition programme in preparation for increased competition (Table 4.3).

[8] New York Times, *A New Post, Chairman, Is Filled by Lufthansa*, 17 June 1970.
[9] Der Lufthanseat, Lufthansa staff newspaper, April 1982, (Cologne: Lufthansa Archives), p. 7.

Table 4.3 Lufthansa planned fleet acquisition, 1991-94.[10]

Planflugzeuge 1991 - 94

(längerfristige Flottenperspektive)

16	B747	(1991 - 94)
4	B737	(1991 - 94)
4	A300	(1991 + 94)
5	A310	(1991 - 93)
25	A320	(1991 - 94)
1	DC8F	(1991)
55	Flugzeuge	

However, debt eventually accumulated as investments, including fleet orders doubled from Deutsche Mark (DM) 5.7 billion between 1987-90 to DM 9.5 billion between 1991-94.[11] In an interesting twist of events, however, the accumulating debt weakened Lufthansa's position to withstand the First Gulf crisis. This chapter later shows how this event eventually prompted important developments at Lufthansa.

4.1.2 Developments under the first two Kohl cabinets, 1982-87

4.1.2.1 Privatisation candidate and motivation

Changes soon took over the West German economy with important ramifications for Lufthansa. In 1982, Helmut Kohl came to power as the German Chancellor after a successful vote of no confidence against the SPD. Kohl eventually formed a coalition including the centre-right CDU/CSU and the liberal Free Democratic Party (FPD).

New proposals ensued under Kohl. Privatisation was an advertised aim of the new cabinet starting 1982, although with no clear commitments. In August 1983, the Finance Minister Gerhard Stoltenberg had a private meeting with federal enterprise leaders about the privatisation plans outlined in the 1983 Annual Economic Report.[12] The Lufthansa privatisation was mentioned, with options for sale being investigated behind closed doors. By 1984, government silence led to speculation and anxiety among Lufthansa employees and government actors worried about potential implications for Lufthansa as the flag carrier.

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[10] German Federal Ministry of Finance, *Possibilities of a Capital Increase at Lufthansa and Reduction of Federal Involvement*, 23 April 1986, B126/159616, (Koblenz: Bundesarchiv). "B" stands for Boeing, "A" stands for Airbus, "DC" is associated with McDonnell Douglas.

[11] Federal Ministry of Finance, *Coverage of Capital Requirements at Lufthansa*, 12 March 1987, B126/159616, (Koblenz: Bundesarchiv).

[12] Federal Ministry of Economics meeting agenda points, *The eventual privatisation of Lufthansa*, August 1983, B102/325325, (Koblenz: Bundesarchiv).

Later the same year, Stoltenberg announced plans for a Lufthansa partial privatisation. The government planned to sell its stake and reduce ownership from 79% to 55% (Table 4.4).

Table 4.4 Lufthansa ownership changes (% stake), 1982-97.[13]

Owners	1982 (First Kohl Cabinet)	1984-85 Government Plan (not initially realised)	1987 (First Lufthansa Capital Increase without State Participation)	1989 (Second Lufthansa Capital Increase without State Participation)	1994 (Partial Privatisation)	1997 (Full Privatisation)
Federal State	79.9	55	69.5	55	38.8	0
North Rhine-Westphalia Land	3	2.25	2.25	2.25	1.7	0
Private (includes bank holdings)	17.8	42.75	28	42	59.5	100

Unlike the UK and BA cases, the Lufthansa privatisation motives were neither predominantly ideological nor economic in nature. Instead, a practical solution was advertised by the Kohl government: "It is our common conviction that it cannot be the task of the state to become entrepreneurially active where private initiative can fulfil tasks better and without compromising state interests".[14] The state further explained its non-economic motives when arguing that "the sale of a Lufthansa package has no connection with budget financing and long-term financial consolidation. Therefore, there is no reason to be hasty".[15] Yet, this third way when related to Lufthansa is also explained by several other reasons:

First, the early German state opted to sell profitable companies compared to the opposite UK example. In this sense there was no economic reason to dispose of a profitable Lufthansa hastily. The coalition reiterated that proceeds from Lufthansa represented "a pleasant side-effect, but not the main objective".[16]

Second, the West German economy was not in the same situation as the UK in terms of inflation or GDP slowdown. As a result, there was little incentive to impose borrowing limits on public companies.

Third, Lufthansa management was already benefiting from less intervention and management from the state. Private minority capital had already been introduced under the airline's legal status as an AG.

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[13] Ministry of Finance, *Comparison of Privatisation Options*, 21 June 1985, B126/143239, (Koblenz: Bundesarchiv); Ministry of Finance, *Capital Holding in Lufthansa*, 1987, B126/143240, (Koblenz: Bundesarchiv); Ministry of Finance, *Solutions for Ownership Problems and Further Privatisation Rounds*, June 1995, B108/110690, (Koblenz: Bundesarchiv). Federal State ownership includes ownership held by Post, Railways, and Development Bank Kreditanstalt für Wiederaufbau as these were also owned by the federal state.

[14] Gerhard Stoltenberg, Finance Minister, private correspondence with Albrecht Feibel, CDU Deputy Chairman, 7 December 1984, B126/143239, (Koblenz: Bundesarchiv).

[15] Franz Josef Strauss, CSU Chairman, interview with Flugbegleiter newspaper, December 1984, B126/143239, (Koblenz: Bundesarchiv).

[16] Manfred Brunner, FDP Bavarian Chairman, interview with Die Welt newspaper, 2 August 1988, B126/143240, (Koblenz: Bundesarchiv).

Last, the government did not endorse or advertise ideological privatisation pursuits like extending wider share-ownership during this period. There were no grand speeches about ideology or the denouncement of nationalisation as an evil which needed addressing.

Despite these reasons for choosing the third-way approach to the Lufthansa privatisation, there were, however, mixed feelings and opposition to the proposed plans.

4.1.2.2 Opposition to privatisation

Opposition manifested from within the coalition, from the media, and Lufthansa employees.

Inside the coalition, the Christian Social Union in Bavaria (CSU) Party Chairman and Minister-President Franz Josef Strauss argued that a privatised Lufthansa would harm Bavarian state interests by no longer supporting the local aerospace manufacturing industry. This may have occurred if Lufthansa favoured procuring Boeing aircraft over Airbus. The Bavarian aerospace manufacturer Messerschmitt-Bölkow-Blohm was involved with the Airbus consortium in producing the A300 aircraft. Strauss opposed the privatisation plans, stirring conflict in the press by claiming that Lufthansa was already managed “according to private-sector criteria” and privatisation was not needed, or accusing the government of selling its “pearls” and keeping the “lame ducks”.[17]

Other key coalition actors from the CSU made their concerns known to the CDU. The Minister of Interior Friedrich Zimmermann introduced the potential problem of nationality clauses to Stoltenberg, while also sharing Strauss’s opinion on Airbus:

> The prerequisites for a reduction of the Federal Government's shareholding in the share capital of Lufthansa from 79.9% to about 55% are, at least at the present time, not given:
>
> Lufthansa's international standing as a "national carrier" would possibly be damaged by a reduction of the Federal Government's share […]. It cannot be in the well-understood interest of the Federal Government to jeopardise the good will built up over the past years and decades through premature privatisation measures.
>
> The Federal Government bears responsibility not only for Lufthansa as the national airline, but also for the Airbus project.[18]

[17] Strauss, interview with Flugbegleiter newspaper, December 1984, B126/143239; Strauss, interview with Frankfurter Allgemeine newspaper, 15 December 1984, B126/143239.

[18] Friedrich Zimmermann, letter to Gerhard Stoltenberg, 21 January 1985, B126/143239, (Koblenz: Bundesarchiv). All German to English translations throughout the chapters are the work of the author of this study.

In contrast to the CDU/CSU, the free-market FDP not only welcomed the news, but asked for a full Lufthansa privatisation. This caused increased conflict between them and the CDU/CSU.[19] The FDP, however, did not budge. The party persisted in asking for a full Lufthansa privatisation even up to 1988, claiming that the overall German privatisation pace was slow.

The press was also divided in its reporting. Some socialist newspapers argued that Lufthansa and the economy were in danger of recreating the "privatisation euphoria" present with BA, demanding "a stop to these bold plans".[20] Others, including the UK press weighed-in on this matter, siding with the FDP by arguing that the privatisation pace was deceptively slow and unlike that proposed by the German state:

> Mr. Stoltenberg was speaking at a news conference designed to stress that, contrary to much domestic and international opinion, there has been steady movement towards a reduced role for the Government in the economy […]. But that includes the sale of quite small stakes in companies like Volkswagen which has a turnover of more than DM 50 billion on its own.[21]

Employees were especially worried about their livelihood. There are two main aspects worth discussing, which are present here:

First, staff stated that with the state renouncing interest in Lufthansa, the company and its employees would be more vulnerable to outside influences and hostile takeovers. Therefore, it was argued that Lufthansa would eventually cease to exist as the German flag carrier and enjoy state protection. Between 1984 and 1985, 9,000 of the 31,500 Lufthansa employees launched petitions against privatisation. Letters were sent to Chancellor Kohl by union leaders asking for reconsideration. At the same time, these documents also criticised the government's confusing communication:

> The employees and the management have created one of the most respected companies in the Federal Republic of Germany; they have made Lufthansa one of the best airlines in the world. A thoroughly healthy company is now up for sale, without need, without explanation. Deep consternation and disappointment are felt

[19] Chancellor Kohl, interview with Die Welt newspaper, 9 December 1988, B126/146288, (Koblenz: Bundesarchiv).
[20] Deutsche Verkehrs-Zeitung newspaper, 2 February 1984, B102/325325, (Koblenz: Bundesarchiv).
[21] Financial Times, 20 December 1988.

> throughout the company. Dear Chancellor, please reconsider this plan together with your cabinet colleagues.
>
> If perhaps the idea behind the plans for privatisation is to abandon Lufthansa as a "national carrier" and all that the company's employees and management have worked for over the past almost 30 years, we must strongly warn against this path.[22]

The government made matters worse by being unclear on the topic. For example, the Transport Minister assured Lufthansa employees that there would be no reduction of state ownership, only to privately plan otherwise.[23] This contrasts with BA, which was more forthcoming and generous with its workforce.

Second, there were legal issues associated with the privatisation. These were especially important as they eventually derailed the privatisation until their resolution in 1994. While Lufthansa was organised as a joint-stock company with private investment, the status of its staff was that of civil servants. Under German law, staff pensions were insured by the Versorgungsanstalt des Bundes und der Länder (VBL), a public institution supported by the federal government and states. The VBL issue was a particularly challenging situation as employees would remain insured only if the government continued to own more than 50% of Lufthansa.

With government plans approaching that ownership threshold, the federal state sought clarification. The VBL president warned that a majority private Lufthansa would have to commit to covering the pensions for all employees due to the change in their status. This amounted to over DM 1.5 billion. In effect, Lufthansa would have been bankrupt due to the lack of resources to fund this.[24] The VBL aspect is returned to later in this chapter.

The challenges within and without had final say. The government chose a passive form of privatisation for Lufthansa for the reminder of the 1980s.

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[22] Lufthansa General Worker's Council, letter to Helmut Kohl, 10 November 1984, B102/325325, (Koblenz: Bundesarchiv); Lufthansa General Worker's Council, letter to Franz Josef Strauss, 10 July 1984, B126/143239, (Koblenz: Bundesarchiv).
[23] Lufthansa General Worker's Council, letter to Strauss, 10 July 1984.
[24] Kurt Schulte, VBL President, letter to Rudi Walther, Chairman of the Bundestag Budget Committee, 13 February 1985, B257/71656, (Koblenz: Bundesarchiv); Federal Ministry of Finance internal report, 15 February 1985, B257/71656, (Koblenz: Bundesarchiv).

4.2 Developments during privatisation, 1987-97

This section examines the passive to active privatisation developments of Lufthansa. As previously highlighted, Lufthansa originally took a gradual approach. However, the government researched the successful privatisation of BA and JAL with the purpose of understanding their success stories related to the rationalisation procedures as well as foreign capital control, share distribution, and what flag carrier privatisation meant for the existing bilateral agreements.[25] A new management was also brought in, which followed similar rationalisation policies as BA just as the Single Aviation Market was becoming a reality. Similar preparations steps were also undertaken as part of the flotation process, including the use of consultancies, IPO sale, and employee share schemes. In this sense, there has been a convergence of the privatisation process with that of BA. The same is shown for AF in the following chapter.

4.2.1 Passive privatisation, 1987-89

4.2.1.1 Share dilution

The government continued its privatisation plan, although through what this study refers to as a passive form of privatisation to raise over DM 300 million for Lufthansa's fleet renewal. This passive privatisation meant that the government simply did not participate in capital increases at Lufthansa in 1987-89. By doing so, the government effectively reduced its share from 70% to 55% through share dilution (Table 4.4, above). Among the new owners, an increase of ownership among banks like Dresdner Bank and insurance companies is noted.

The passive privatisation developments came at a more favourable time for the government to justify moving forward. Opposition from CSU was also dwindling as Strauss passed away in 1988. The new CSU Chairman was Theo Waigel. Kohl appointed Waigel as the new Finance Minister over Stoltenberg during the third Kohl cabinet of 1987-91. Unlike Strauss, Waigel favoured privatisation as the "best form of restructuring. The private investor takes over all the risks and opportunities […]".[26] Waigel also pursued the Lufthansa privatisation with more interest in solving the VBL issue. Furthermore, previous fears that Lufthansa would stray away from Airbus purchases did not materialise. Lufthansa invested in Airbus acquisitions like the A320 aircraft for its late 1980s fleet renewal programme.[27]

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[25] German Ministry of Finance internal report, *Personnel Cost Comparison of Different Airlines*, 25 March 1987, B126/143240, (Koblenz: Bundesarchiv); German Ministry of Transport meeting agenda with Japanese Ministry of Transport, 24 May 1985, B126/143239, (Koblenz: Bundesarchiv).
[26] Theo Waigel, in the Financial Times, 3 July 1992.
[27] Dresdner Bank, report on Lufthansa operations, August 1994, B108/110690, (Koblenz: Bundesarchiv).

4.2.1.2 Behind the scenes preparations amid liberalisation pressures

The government, however, was researching, behind the scenes, the next steps for moving beyond a passive privatisation. This impetus started taking over as the EEC First Liberalisation Package was adopted in 1987 and the aim of the single market was becoming a reality. Similar to the private BA, the state-owned Lufthansa was now also operating against the liberalisation clock.

In 1988, Chancellor Kohl publicly conveyed his displeasure on the overall pace of the Lufthansa privatisation.[28] Privately, Ruhnau, the Lufthansa board, and the Finance Ministry representatives lamented the passive Lufthansa approach, citing the examples of the recent BA and JAL full privatisations:

> If one were to ask the German embassies for reports on airline privatisations and exact figures on the reduction of state holdings, a considerable list would be compiled. The question would be even more justified today why, in the Federal Republic of Germany of all places, aviation policy is only feasible with a capital majority in the "national carrier"?[29]

In staff newspapers, Ruhnau proclaimed that "in a Europe of nation-states, Lufthansa intended to operate as a European airline with a German stamp" in the context of the upcoming Single Aviation Market.[30]

Behind the scenes, however, the government now had the example of the successful sale of BA and its rationalisation policies. Comparisons between BA and Lufthansa were increasingly more common within internal government reports:

> The rationalisation measures carried out at BA in recent years […] have obviously improved the company's personnel cost structure considerably. BA's personnel costs as a percentage of total costs fell from 27.4% in 1982 to 23.0% in 1986. BA has thus been able to secure a considerable cost advantage—at least over most of its European competitors.[31]

[28] Kohl, interview with Die Welt newspaper, 9 December 1988, B126/146288, (Koblenz: Bundesarchiv).
[29] Ministry of Finance representative Dr. Knauss, discussion preparations for the 2 December 1988 meeting with Mr. Ruhnau, 1 December 1988, B126/143240, (Koblenz: Bundesarchiv).
[30] Heinz Ruhnau, in Der Lufthanseat staff newspaper, 3 June 1988, (Cologne: Lufthansa Archives).
[31] Ministry of Finance internal report, *Personnel Cost Comparison of Different Airlines*, 25 March 1987, B126/143240, (Koblenz: Bundesarchiv). Underscores reproduced from the original report.

German officials also met with the Japanese Ministry of Transport representatives to enquire about the 1987 JAL privatisation preparations, the other important full airline privatisation of the time.[32] While the contents and discussions of the meeting remain classified, the agenda features questions addressed to the Japanese side on matters like government share reduction policies, foreign capital control, and privatisation legal regulations. The German side was very much interested in the way others were structuring airline privatisation.

With the EEC Second Liberalisation Package launched in 1990, the German state was more adamant that Lufthansa "must first and foremost grow under its own resources".[33] In the press, Economics Minister Jürgen Möllemann argued that Lufthansa "should privatise as quickly as possible", blaming previous opposition from the Bavarian CSU and the VBL issues as the reasons why a full privatisation had not been possible.[34]

Indeed, the Lufthansa privatisation process was developing quicker than before amid liberalisation pressures, but also due to lesser domestic opposition. Nonetheless, VBL issues persisted for the time being. Besides this, crisis soon hit Lufthansa because of the early 1990s First Gulf War. The government had no options but to temporarily halt further privatisation developments until Lufthansa recovered.

4.2.2 Crisis and new management, 1990-94

4.2.2.1 Crisis hits

The early 1990s started in the worst possible way for the German government, Lufthansa, and the rest of the civil aviation industry. The First Gulf War crisis affected international traffic. As presented in Chapter 3, BA weathered this storm in a capable manner due to its healthy post-privatisation state. However, this crisis hit in the middle of a renewed push for privatisation for Lufthansa. The fleet renewal programme started in 1988 also went over previous budgetary targets, totalling over DM 13 billion by 1993.[35] This weakened Lufthansa's stance as Europe's historically profitable flag carrier, especially in the wake of the newfound BA success story.

Table 4.5 highlights the unprofitable period starting 1990, where net income, investments, and cash flow were reduced. A weakened cash flow meant that less funds were

[32] German Ministry of Transport meeting agenda with Japanese Ministry of Transport, 24 May 1985, B126/143239, (Koblenz: Bundesarchiv).
[33] Ministry of Transport, report on Lufthansa investment policy, 27 March 1990, B126/143240, (Koblenz: Bundesarchiv).
[34] Jürgen Möllemann, in Bild newspaper, quoted in Smith New Court Europe, asset management firm, report on Lufthansa, 9 December 1991, B108/110688, (Koblenz: Bundesarchiv).
[35] Smith New Court Europe, report on Lufthansa, 9 December 1991, B108/110688, p. 10.

being invested into Lufthansa. The number of employees also accumulated over recent years as the business expanded. This led to losses at Lufthansa between 1991-93, for the first time since the early 1970s.

Table 4.5 Lufthansa net income/loss, investments, cash flow, and employees, 1988-2007.[36]

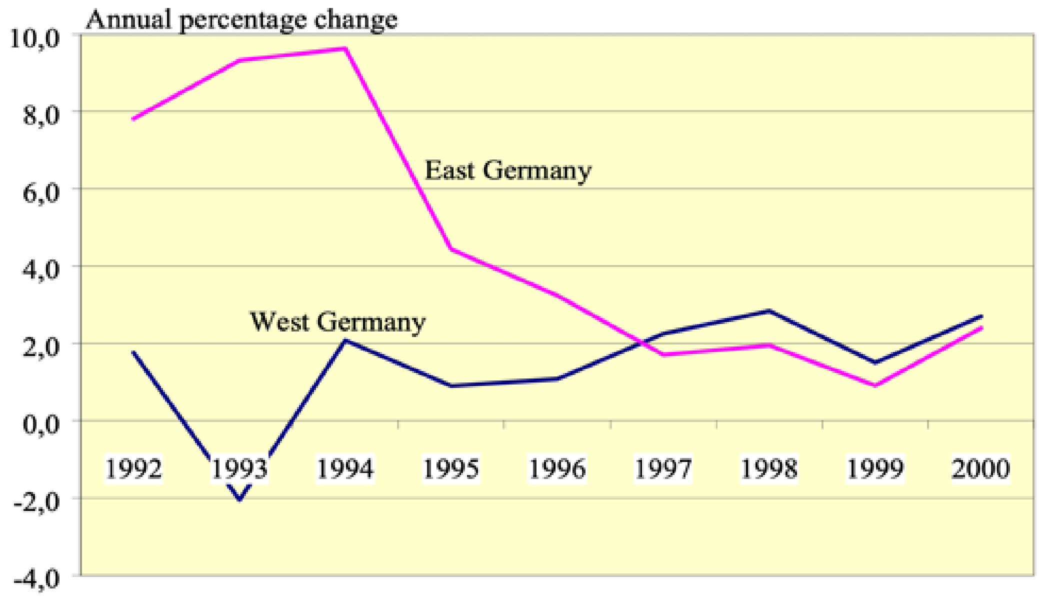
Year	Net Income or Loss (in million DM and Euro)	Investments (in million DM and Euro)	Cash Flow (in million DM and Euro)	Employees
1988	81.6	2,418	1,572	49,056
1989	109.7	2,299	1,845	51,942
1990	15.2	3,656	1,577	57,567
1991	-425.8	3,042	1,768	61,791
1992	-391.1	2,669	1,595	63,645
1993	-91.6	1,741	1,930	60,514
1994	302	2,086	2,530	58,044
1995	1,476	1,365	2,482	57,586
1996	558.1	1,987	2,440	57,999
1997	1,076	2,364	3,906	55,520
1998	1,431	3,711	3,638	54,867
1999	1,233	3,789	1,582	66,207
2000*	445	1,212	2,140	69,523
2001	-797	1,276	1,736	87,975
2002	1,111	880	2,312	94,135
2003	-1,223	1,155	1,581	94,798
2004	265	1,783	1,881	92,743
2005	455	1,829	1,956	90,811
2006	523	1,929	2,105	93,541
2007	1,123	1,737	2,862	100,779

The government was also confronted with the logistics behind German reunification starting July 1990. The costs of reunification are estimated to be upwards of 1.3 trillion Euros.[37] The government ran a budget deficit as a result of attempting to integrate the formerly centrally planned East German economy. The GDP growth was also decreasing

[36] Lufthansa Annual Reports 1988-2007, (Cologne: Lufthansa Archives). "*" denotes that the annual reports began using the newly introduced Euro currency from the year 2000 onward, replacing the DM currency in Lufthansa's financial reporting.
[37] Halle Institute for Economic Research (IWH), cited in Reuters, 8 November 2009.

due to the costs of reunification, represented in Figure 4.6. In a similar situation to the UK yet within an entirely different context, the German state now also had to worry about economy-wide spending as well as the situation at its flag carrier.

Figure 4.6 GDP growth in West and East Germany after reunification, 1991-2000.[38]



The German economy also entered a recession in 1992-93. As a result, there was a new impetus to German privatisation by 1992—keeping borrowing under control, but also benefiting from privatisation proceeds potentially worth billions of DM. Lufthansa was at the forefront of this plan, being singled out. In 1992, Waigel publicly announced that "the goal remains the complete withdrawal of the federal Government from the company".[39] However, a new strategy was needed for Lufthansa to recover before privatisation could proceed.

4.2.2.2 "The crane is by no means lame": new management and rationalisation

In 1991, Jürgen Weber assumed the Lufthansa chairman role after Ruhnau stepped aside (Picture 4.4).[40] Like Culmann, Weber had a long history with Lufthansa. Weber studied aeronautical engineering at Technische Hochschule Stuttgart (now Stuttgart University), joining the Lufthansa engineering division in 1967. He became Technical Services general manager in 1987, and later executive. In 1990, Weber was appointed to the Lufthansa

[38] Graph and data by Hans-Werner Sinn, Ifo Institute, *Germany's Economic Unification: An Assessment After Ten Years*, National Bureau of Economic Research Working Paper 7586, (Massachusetts: National Bureau of Economic Research, 2000).
[39] Theo Waigel, Federal Finance Minister, in the New York Times, 22 July 1992.
[40] Der Lufthanseat, Lufthansa staff newspaper, May 1991, (Cologne: Lufthansa Archives).

executive board.[41] Nicknamed "Mister Lufthansa" by the press for his long-term association with the carrier, Weber's task was not easy—to achieve a quick recovery within a few years, prove that "the crane [Lufthansa symbol] is by no means lame", and restart the privatisation process.[42]

Picture 4.4 Jürgen Weber, Lufthansa chairman and successor to Ruhnau (1991-2003).[43]

Yet Weber had such an example with BA. Weber underscored "the need for the airline to seek further productivity improvements along the lines of the successful British Airways".[44] The Lufthansa Board and German Transport Minister Matthias Wissman later also publicly admitted that "British Airways has shown us the way and we want Lufthansa to become a global player in Europe like BA".[45] There are several examples that highlight how Weber and Lufthansa followed in King's footsteps and his rationalisation plan at BA.

Weber embarked on a cold-turkey rationalisation strategy called "Programme 93" after the planned year of recovery, 1993. This strategy aimed at cost-cutting unprofitable routes and re-orientation toward transatlantic routes, addressing overstaffing, and retiring older aircraft, among other measures meant to streamline operations. For example, transatlantic routes were also strategic to Lufthansa, not just BA, especially in the context of the late 1980s rising transatlantic demand.

[41] Der Lufthanseat, Lufthansa staff newspaper, May 1991, (Cologne: Lufthansa Archives).
[42] Günther Krause, Transport Minister, phrase mentioned in interview with the Bild newspaper, February 1992, B108/110688, (Koblenz: Bundesarchiv); Deutsche Verkehrs-Zeitung, 6 May 2013.
[43] Picture copyright belongs to Lufthansa, featured in Aero.de interview with Jürgen Weber, 20 January 2020.
[44] Jürgen Weber, in Der Lufthanseat, 16 December 1994.
[45] Wolfgang Röller, chairman of the Lufthansa supervisory board, and Matthias Wissman, Transport Minister, interview in the UK Guardian, 5 May 1994.

This is why Lufthansa began operating new services to Canada starting the summer of 1994, including new destinations to Calgary, Ottawa, and Edmonton. Nonetheless, Weber cut unprofitable daily routes from Hamburg and Bonn to New York to also develop its more established international hubs at Frankfurt and Düsseldorf and increase services to North America. Other unprofitable services to North America were cut, including Philadelphia and Santo Domingo, while Montevideo and Salvador were cut from the Lufthansa 1994 South American routes.

In Europe, Lufthansa consolidated its position by expanding its services to new destinations, including Florence, Riga, and Kyiv, among other. At the same time, however, unprofitable European routes like Belgrade, Bristol, and Tirana, among other, were also cut. A comparison between the Lufthansa route maps of 1994 and 1989 is presented below in Picture 4.5.[46]

Picture 4.5 Lufthansa route map comparison 1994 (above) and 1989 (below).[47]

[46] New York Times, 28 November 1993.

[47] Lufthansa Annual Reports 1988, 1993. “B” denotes Boeing aircraft, “A” is Airbus”, and “DC” represents McDonnell Douglas.

Programme 93 was summarised to the staff:

> The workforce is to be reduced by 3,000 jobs annually in both 1993 and 1994. Most of these will be office jobs. Together with the job reductions this year [1992], the cuts will trim about 8,000 people off the Lufthansa payroll by the end of 1994 compared with the workforce level at the start of 1992. This is equivalent to a reduction of about 15 per cent. Earnings are to be raised by about 700 million DM through numerous activities on the sales front. These include a new product on European routes, improved yield management and the introduction of our new passenger-loyalty bonus programme "Miles&More" in 1993. Load factors are to be improved through more aggressive pricing […].[48]

Ironically, Ruhnau's fleet replacement programme which drained Lufthansa resources in the late 1980s now became especially useful for the German flag carrier's recovery. Lufthansa's fleet modernisation ensured that the average fleet age measured at the end of 1991 was around 6.5 years, the second "youngest" in the world after the 4.8 years of Singapore Airlines, but "younger" than its main European competitors BA (9.7 years) and AF (10.6 years).[49] This is noteworthy as older aircraft are more expensive and inefficient to operate amid rising fuel costs, while newer aircraft also enjoy improvements in load factors.

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[48] Der Lufthanseat, September 1992, (Cologne: Lufthansa Archives).

[49] Smith New Court Europe, report on Lufthansa, 9 December 1991, B108/110688, p. 7.

Even the on-board news service was changed from the German Deutsche Welle to the British BBC due to the rising number of international and intercontinental passengers, much to the anti-German criticism of the former news broadcaster.[50] The recovery is highlighted in Tables 4.5 (above) and Table 4.6 (below).

Table 4.6 Lufthansa load factor, personnel costs/sales, and employee productivity, 1988-97.[51]

Year	Load Factor (%)	Personnel Costs/Sales (%)	Employee Productivity (tonnes-kilometres)
1988	66	33	237,993
1989	66	33	239,927
1990	67	33	237,629
1991	64	32	231,299
1992	65	34	257,205
1993	68	31	282,966
1994	70	28	313,724
1995	70	27	347,015
1996	70	28	356,860
1997	71	26	373,178

Lufthansa made a quick recovery within just a few years. Like BA, Lufthansa improved its profitability, load factor, and reduced its workforce. Similar to BA, there were also voluntary redundancies, and the workforce was accommodated with severance packages. Lufthansa also reduced its personnel costs relative to total sales. A low percentage was desired here to reduce labour-intensive inputs. Employee productivity improved after 1992 as a result.

Weber also pursued the strategy of scale immediately after becoming chairman. Indeed, toward the end of his tenure Ruhnau also realised that "there is a simple law in a free market economy: bigger eats smaller" as exemplified by the U.S. airline deregulation experience.[52] Yet Weber highlighted that this strategy was imperative in the context of the single market formation, where state aid would become limited and competition abundant.

[50] Deutsche Welle representatives, letter to Jürgen Weber, 27 January 1993, B108/110688.
[51] Lufthansa Annual Reports 1989-98. The study recalls that the measure of tonne-kilometres in this context refers to the average employee productivity. This metric indicates the average traffic flown, expressed in tonnes per kilometre that is generated from the output of each employee. It includes passengers and cargo. The higher the figure, the more revenue and productivity is generated from each employee.
[52] Heinz Ruhnau, in Der Lufthanseat, February 1990, (Cologne: Lufthansa Archives).

Just as King, Weber also perceived transatlantic partnerships as essential to this strategy of scale. This point is returned to when discussing partnerships and alliances.

With the quick recovery, privatisation could seemingly resume. However, the VBL hurdle and the issue of conciliating employees were still present.

4.2.3 Active privatisation, 1994-97

4.2.3.1 The VBL solution

The VBL hurdle proved complicated to solve. With every passing year, the VBL fund estimates continued to rise in the case of privatisation, ranging anywhere between DM 1 billion to DM 2 billion. At these sums, it was argued by the government that "this effort is not acceptable for the company. It would cause incalculable damage".[53] The government was afraid that stock markets would also react negatively to the news, effectively hindering the sale even before flotation. Moreover, the government believed that even the proceeds from a successful privatisation would not be enough to cover these pension claims:

> The mandatory disclosure of the facts in the context of a capital increase would burden the stock exchange price to such an extent that a capital increase with a privatisation excluding VBL participation would not be economically feasible.
>
> Even if the federal government wanted to compensate for the pension problem from privatisation proceeds, this would not be possible at present. The Federal Government would have to sell at DM 200 per share to be able to offset only the VBL burden. At the current selling price […], the federal government would have to inject non-financeable sums (around DM 1 billion!).[54]

Legal and financial experts summarised the government's options as following:

1. Lufthansa's employees can stay in the VBL. This is the best case scenario for Lufthansa. Current liabilities are fully covered so that no additional payment falls due on privatisation.

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[53] Transport Ministry, letter to Heinz Ruhnau, *VBL Participation in Lufthansa*, 30 May 1990, B257/71656, (Koblenz: Bundesarchiv).

[54] Transport Ministry, *Lufthansa privatisation within the VBL context*, 15 May 1991, B257/71656, (Koblenz: Bundesarchiv); Transport Ministry, letter to Heinz Ruhnau, *VBL Participation in Lufthansa*, 27 June 1990, B257/71656, (Koblenz: Bundesarchiv).

2. Lufthansa's employees are not able to stay in the VBL scheme and are forced to take up a private pension scheme.

a. There is no impact on current pensioners, as they will remain in the VBL scheme. It is estimated that future pension liabilities amount to a discounted sum of DM 1 billion. We assume that this amount would have to be paid directly after privatisation.

b. Lufthansa has paid between DM 2 bn and DM 3 bn for its current staff, since 1955. If Lufthansa has to exit from the VBL scheme, it is not certain whether funds can also be withdrawn. Pension schemes in Germany are not as sophisticated as in some other European countries where the money paid for every single employee can be calculated and refunded on withdrawal from a pension scheme.[55]

Yet the first option was not viable within the Lufthansa privatisation plans. Negotiations between the government, Lufthansa, and the VBL began in search for a solution.

The "amicable" breakthrough was announced in May 1994, after "time-consuming" negotiations.[56] The solution was government intervention and payment of over DM 1.55 billion for the following 15 years to secure the pensions of existing employees.[57] Lufthansa would also have to create and fund its own separate pension plan for new staff. The press welcomed the news, congratulating Lufthansa on clearing the "hurdle", while ministers argued that this opened the way for Lufthansa to become a "global player".[58]

The VBL solution is important for three main reasons:

First, Lufthansa had no VBL burden attached to itself anymore. The perceived threat of bankruptcy was now dispelled. In this sense, it was free to pursue further privatisation and to build international partnerships just as the European and world markets were becoming more competitive.

Second, the government could now accomplish its Lufthansa privatisation aim, especially during the challenging context of reunification and the rise of airline deregulation. Active privatisation became the next step. Nonetheless, it is important to note the role of the

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[55] Quotes from Smith New Court Europe, report on Lufthansa, 9 December 1991, B108/110688, p. 23.
[56] Press Release by Finance Minister Theo Waigel and Transport Minister Matthias Wissmann, 23 June 1994, B108/110689, (Koblenz: Bundesarchiv).
[57] Transport Minister Matthias Wissmann, letter to German Cabinet Chief of Press and others, 16 May 1994, B108/110689.
[58] Financial Times, 5 May 1994; Waigel and Wissmann, 23 June 1994, B108/110689.

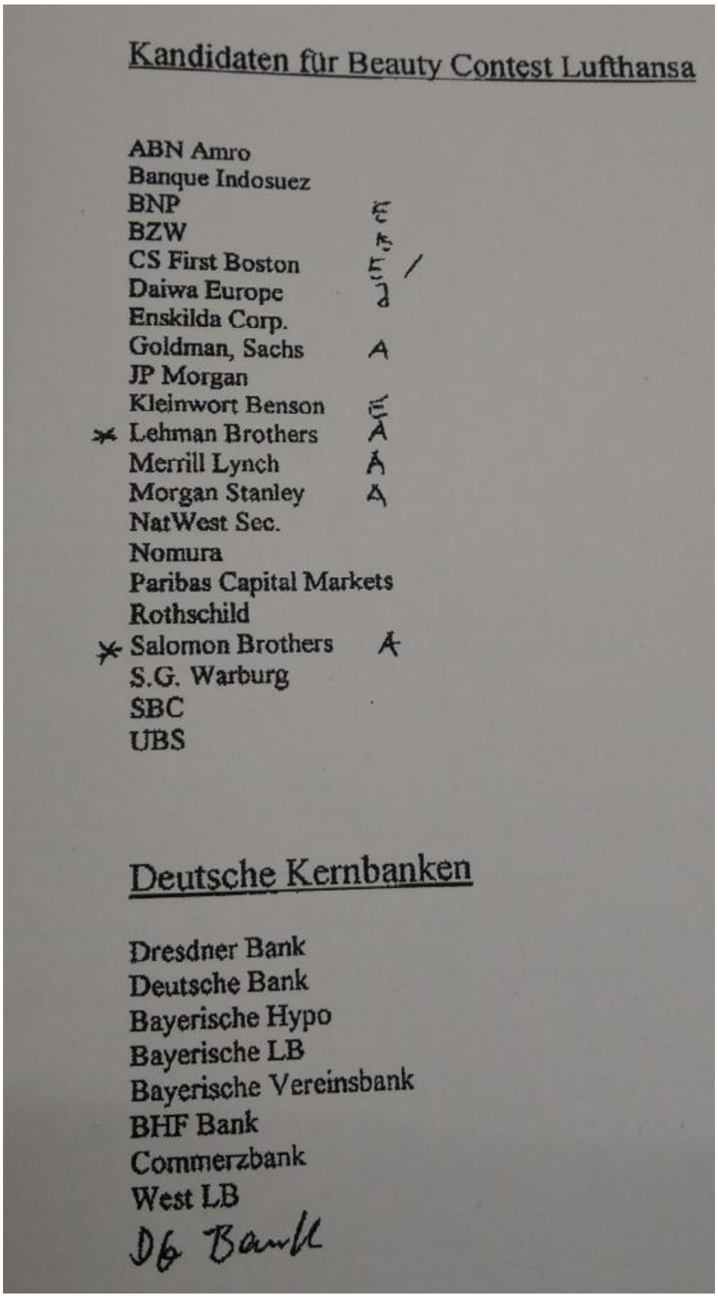
state in helping Lufthansa with the VBL issue. Similar to BA, the state has directly intervened here as well to push forward the privatisation. It is sensible to consider that without the state's involvement with the VBL, the situation could have been different for Lufthansa. In this sense, this direct help enjoyed by Lufthansa also positioned the flag carrier in a more favourable situation post-privatisation than otherwise.

Third, the most pressing issue facing the employees was now over. The VBL and the government committed to securing the pension claims and livelihoods of Lufthansa staff. Privatisation planning proved not to be damaging to their livelihoods as employees believed in the 1980s. Employee status also changed ahead of flotation. This is discussed in the following section.

4.2.3.2 Flotation preparations: consultancies and employees

Just as in the BA case, there exists an element of transnational linkages regarding privatisation and industry characteristics, represented by international consultancies. With the VBL issue resolved, the government moved from passive to active privatisation by actively selling its shares through an IPO flotation. The government moved fast in employing the services of international consultancies. The same consultancies were employed during the 1994 and 1997 sales. The same consultancies also took part in the BA and Lufthansa privatisations (Picture 4.6).

Picture 4.6 Lufthansa consultancies "Beauty Contest" (above) and chosen underwriters by region (below), 1994.[59]



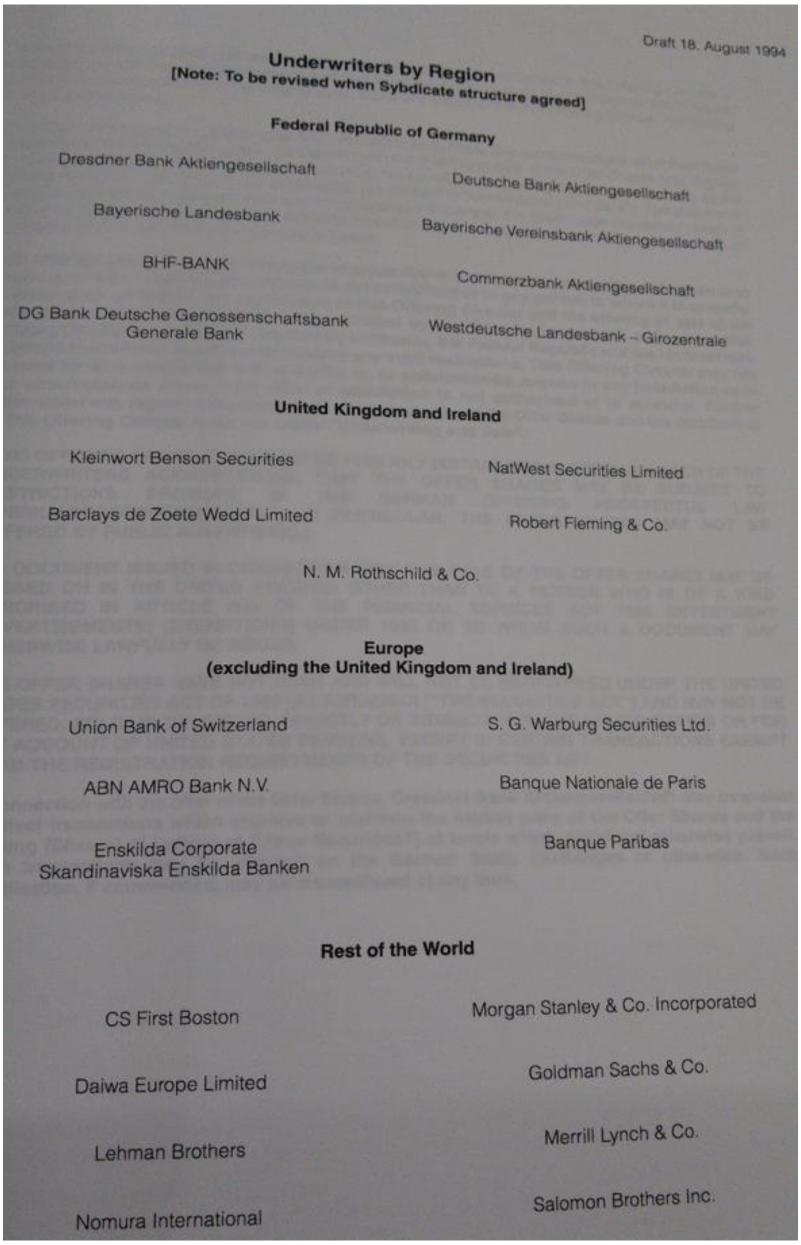
Kandidaten für Beauty Contest Lufthansa

ABN Amro	
Banque Indosuez	
BNP	E
BZW	E
CS First Boston	E /
Daiwa Europe	J
Enskilda Corp.	
Goldman, Sachs	A
JP Morgan	
Kleinwort Benson	E
* Lehman Brothers	A
Merrill Lynch	A
Morgan Stanley	A
NatWest Sec.	
Nomura	
Paribas Capital Markets	
Rothschild	
* Salomon Brothers	A
S.G. Warburg	
SBC	
UBS	

Deutsche Kernbanken

Dresdner Bank
Deutsche Bank
Bayerische Hypo
Bayerische LB
Bayerische Vereinsbank
BHF Bank
Commerzbank
West LB
DG Bank

[59] Lufthansa, Preliminary international offering circular, 18 August 1994, B126/146288, (Koblenz: Bundesarchiv); Dresdner Bank, list of privatisation consultancies, 13 June 1994, B126/146288. "E" denotes Europe, "A" is the U.S., and "J" represents Japan. These letters represent the regions where the banks had their headquarters located.



Draft 18. August 1994

Underwriters by Region
[Note: To be revised when Sybdicate structure agreed]

Federal Republic of Germany

Dresdner Bank Aktiengesellschaft	Deutsche Bank Aktiengesellschaft
Bayerische Landesbank	Bayerische Vereinsbank Aktiengesellschaft
BHF-BANK	Commerzbank Aktiengesellschaft
DG Bank Deutsche Genossenschaftsbank Generale Bank	Westdeutsche Landesbank – Girozentrale

United Kingdom and Ireland

Kleinwort Benson Securities	NatWest Securities Limited
Barclays de Zoete Wedd Limited	Robert Fleming & Co.
N. M. Rothschild & Co.	

Europe
(excluding the United Kingdom and Ireland)

Union Bank of Switzerland	S. G. Warburg Securities Ltd.
ABN AMRO Bank N.V.	Banque Nationale de Paris
Enskilda Corporate Skandinaviska Enskilda Banken	Banque Paribas

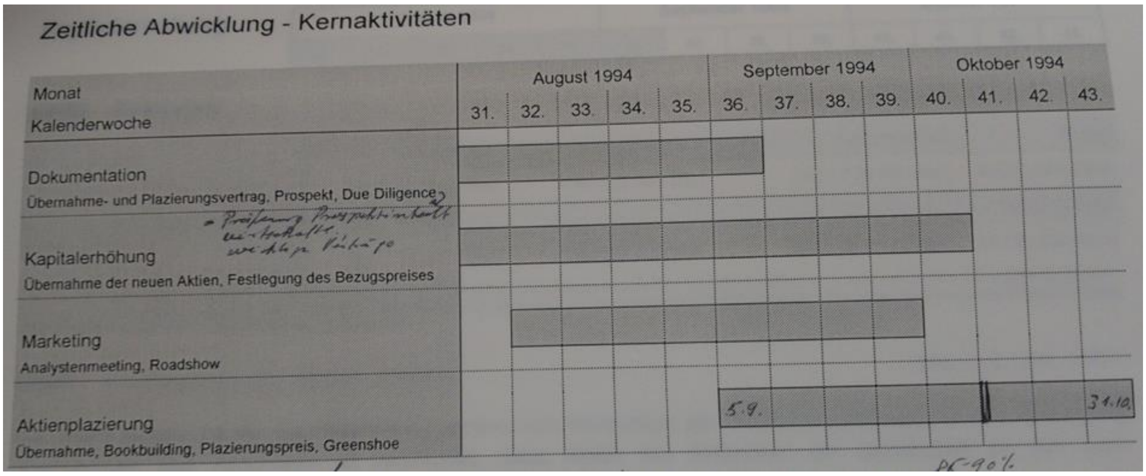
Rest of the World

CS First Boston	Morgan Stanley & Co. Incorporated
Daiwa Europe Limited	Goldman Sachs & Co.
Lehman Brothers	Merrill Lynch & Co.
Nomura International	Salomon Brothers Inc.

The results were also similar in terms of the roles these consultancies assumed. On the German side, Dresdner Bank and Deutsche Bank were the leading domestic banks in charge of the flotation. This meant that these were tasked with setting the share price, advertising, and meeting with other leading investors through so-called roadshows, among other duties. For example, the Dresdner Bank provisional schedule for the Lufthansa privatisation is represented below in Picture 4.7. Here, the Dresdner Bank schedule highlights flotation planning activities between August and October 1994, including flotation documentation, sale prospectus, and flotation price setting, among other planning.

European consultants like Rothschild and Kleinwort Benson offered underwriting services for Lufthansa within UK markets. In the rest of the world (outside of Europe, but predominately the U.S.), Lehman and Goldman Sachs, alongside Morgan Stanley were made the lead managers of the sale on international markets. These consultants provided brokerage advice and marketing. Like BA, Nomura was also the lead manager of the Lufthansa sale in Japan.

Picture 4.7 Dresdner Bank example schedule for Lufthansa privatisation (above) and advert (below) in the Financial Times, 1994.[60]



For both 1994 and 1997, the IPO was the method of choice for the Lufthansa sale, following in the steps of BA. This was chosen as to achieve a broader distribution of shares and gain international coverage. However, unlike BA, there were no specific ideological aims to extend wider-share ownership advertised. Nonetheless, the finally awaited Lufthansa

[60] Dresdner Bank, list of privatisation consultancies, 13 June 1994, B126/146288, (Koblenz: Bundesarchiv); Financial Times advert, 5 October 1994.

privatisation received sufficient worldwide coverage and advertisement in the media, including the Financial Times, Guardian, and Neue Zeit as it was ready for “take-off”.[61]

Like BA, Lufthansa employees were offered share options. However, this did not happen in the 1994 sale as the government believed these discounted employee shares valued at DM 50 million should “not be approved in view of the financial situation of Lufthansa and possible losses for the Federal Government when selling its shares”.[62] Lufthansa was recovering from the early 1990s unprofitability. Dividends were not awarded for the 1993 fiscal year. In this situation, offering discounted staff shares was deemed inappropriate.

Nonetheless, discounted shares were offered during the second and final tranche of the active privatisation. These shares were offered at a 10% discounted share price for Lufthansa employees.[63] The employee offer was 4 times over-subscribed in the 1997 sale. Weber endorsed this employee interest as a “magnificent show of confidence in their own work and the company”.[64] Over 18,000 Lufthansa employees ordered 6.25 million shares valued at DM 50 million at a discounted price of DM 29.97 per share. The maximum number allocated for individuals was fixed at 87 shares “to ensure as fair and as wide a distribution as possible”.[65] With Lufthansa employees opting to buy shares within the company, they joined BA staff in becoming owners of their own airline. In this aspect, their status changed from civil servants to private shareholders by means of the IPO flotation.

The Lufthansa privatisation example reconfirms the cases of consultancies as transnational actors and employees as share-owners. These aspects have become industry characteristics, as portrayed by the BA example, and as presented with AF in the following chapter.

4.2.3.3 Flotation outcomes

The two and final sales proceeded in the month of October for both the 1994 and 1997 flotations. Just as the BA flotation, the Lufthansa sale was successful. It generated an estimated total of over DM 6 billion (over 2 billion USD) in proceeds during the two flotations, it matched the proposed shared prices indicating a good valuation of Lufthansa, but also highlighted a pronounced investor interest in the sales in light of the Lufthansa

[61] See as example Financial Times, 5 October 1994, The Guardian, 11 September 1994, Neue Zeit (former East German publication), 5 May 1994.
[62] Transport Ministry, *Lufthansa Capital Holding*, 10 May 1994, B126/159616, (Koblenz: Bundesarchiv).
[63] Der Lufthanseat, 26 September 1997, (Cologne: Lufthansa Archives), p. 5.
[64] Der Lufthanseat, 17 October 1997, p. 5.
[65] Der Lufthanseat, 17 October 1997, p. 5.

recovery (Table 4.7). As a result, Lufthansa welcomed more than 400,000 new individual investors for the 1997 flotation.[66]

Table 4.7 Lufthansa 1994/1997 flotations share price, shares issued, and sale proceeds.[67]

Year	Share price (in DM)	Shares issued (in millions)	Sale proceeds (in billion DM)
1994	182	5	2.1
1997	33.3	143	4.7

After more than 40 years under government ownership, Lufthansa was now fully private (Picture 4.8). Weber congratulated Lufthansa staff on this accomplishment, before bidding farewell to state ownership:

> October 13 is an important date in Lufthansa history. We're fully in private hands. We see this as a testimony of our ability to stand up to European and global competition. This new freedom will give us more trust to spread our wings.
> Adieu![68]

[66] Associated Press, 13 October 1997 broadcast, AP Archives, Retrieved from: https://www.youtube.com/watch?v=-A8IH8JUw30 [Accessed on 31 October 2022].
[67] Dresdner Bank, internal Lufthansa privatisation report, August 1994, B126/146288; Financial Times, 13 October 1997; Der Lufthanseat, 7 October 1994; Der Lufthanseat, 17 October 1997.
[68] Der Lufthanseat, 17 October 1997.

Picture 4.8 Weber with new shareholders celebrating the full Lufthansa divesture in front of the Frankfurt Stock Exchange, 13 October 1997.[69]

Transport Minister Wissmann also congratulated Lufthansa staff, giving credit to Weber for the recovery and employees for their hard-work in bringing the airline to an "excellent shape".[70] Wissmann further added that "a private airline in an increasingly liberated airspace is the only significant decision. And I think we took this decision at the right time".[71] In a similar manner, international publications, including the Financial Times, and leading banks, like Dresdner Bank, highlighted the "strong national and international interest" in the flotation.[72]

Some comparisons can be drawn with the BA flotation to put things in perspective. Lufthansa overall proceeds outmatched BA, although Lufthansa had fewer initial investors than BA. However, it is difficult to compare like-with-like given different market conditions and sale contexts. BA was Europe's first full airline divesture. This brought a certain degree of insecurity about whether there was sufficient demand. The excessive BA share under-pricing confirms this. Lufthansa took a gradual approach dictated by the market and internal factors in the wake of the First Gulf crisis. The post-1994 Lufthansa recovery also helped stimulate interest in the sale after a tried-and-tested rationalisation programme.

[69] Der Lufthanseat, 17 October 1997, copyright belongs to Lufthansa.
[70] Der Lufthanseat, 17 October 1997.
[71] Associated Press, 13 October 1997.
[72] Financial Times, 13 October 1997.

Nonetheless, the newly private Lufthansa also had to worry about increased competition and strategy to now survive the rigours of the deregulated market. Indeed, the Lufthansa privatisation proceeded gradually. However, Lufthansa developments would only intensify after flotation in the form of cooperation and alliances. After the success of the Star Alliance, Lufthansa also established the Lufthansa Group. This group was formed due to Lufthansa's aim of consolidating its presence within the European market by way of several mergers. This occurred as a reaction to the 2004 AF-KLM merger and the more recent 2011 IAG merger between BA and Iberia.

4.3 Developments after privatisation, 1997-2007

This final section explores the major developments at Lufthansa in the 10 years after privatisation. Like BA and the industry, Lufthansa also fits within the "3C's" configuration by pursuing cooperation, alliance, and ultimately mergers to survive competition and deregulation. As a result, Lufthansa also contributed to the consolidation of the European industry. Nonetheless, the study notes a slight difference where Lufthansa skipped the investment period, instead focusing on code-sharing agreements due to the single market timeframe. The result, however, is the same as BA—the eventual formation of a major alliance. The German government also assumed an indirect role throughout this period to facilitate Lufthansa's strategy of scale, indicating the continued relationship between state and flag carrier even after privatisation. The section ends with a brief overview of developments since 2007, including the establishment of the Lufthansa Group and the COVID-19 bailout.

4.3.1 Post-1997 deregulation worries

The European single market had already been set in motion by the time of Lufthansa's final privatisation. Besides the increased competition, which was already becoming more present in the market, there were other aspects which characterised this immediate post-1997 period. These were especially true for Lufthansa at the time. As previously mentioned in Chapter 3, the EU was more critical and limiting on flag carriers receiving state aid. In this sense, the EU argued that state aid distorted competition by means of state favouritism and bailouts. This, of course, was another important aspect which eventually pushed other states, including France and airlines more decisively into privatisation. The EU, nonetheless, approved which state-owned airlines would be eligible for state aid in exchange for future conditions of liberalisation, including gradual divesture and abolition of tax advantages.

In the context of pronounced European liberalisation, the number of these ailing airlines increased throughout the 1990s, including carriers like AF, TAP Portugal, and the Greek Olympic.[73] Other airlines that favoured liberalisation and had experience with divesture, like BA, SAS, and KLM also put pressure on the EU to further restrict state aid. While not all challenges against bailouts were successful (this is addressed in the chapter on AF), state aid was becoming increasingly controversial. In this sense, flag carriers regardless of ownership could seemingly no longer fall back on state bailouts as a safety net. Yet special circumstances, including the COVID-19 pandemic, have more recently bucked this trend. Nonetheless, for the 1990s context, the message to Lufthansa was clear—it could no longer depend on a guaranteed government aid as it had benefited with the VBL situation.

Another worry for Lufthansa was the limited access to the U.S. market, but also the pronounced competition coming from U.S. carriers on transatlantic routes. Indeed, this was a common worry in the industry even with BA. For Lufthansa, this worry was summarised within an internal CDU/CSU newsletter signed by Dirk Fischer, the CDU/CSU transport policy spokesman and Hamburg CDU chairman:

> There are unresolved capacity problems. The relationship over the North Atlantic, the most important route for German airlines, has changed in recent times in favour of the U.S. carriers, which have gained a lot of ground due to low prices. Currently, Lufthansa and LTU [named Lufttransport-Unternehmen, a German leisure airline] have a market share of just under 40% on this route. In the longer term, however, the share of German airlines should rise to 60%. Another problem is comparable competitive conditions on the American market itself. Here, German airlines are clearly at a disadvantage. What is needed there is co-sharing with U.S. carriers and broad access to the domestic American market.[74]

Yet, Fischer and the CDU/CSU concerns eventually transpired into policy-making. On this matter, the German government renegotiated the bilateral agreement with the U.S.. In February 1996, an accord was signed for more liberal terms on the first *seven freedoms of the air*. This included, among other conditions, the relaxation of capacity and route frequency controls, as well as unrestricted code-sharing. Lufthansa hubs, including Frankfurt, Munich, and Düsseldorf, would now see increased transatlantic services. This bilateral was eventually superseded by the EU multilateral treaty with the U.S..

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[73] European Commission press release, *Commission confirms its position on aid to Air France*, 22 July 1998.
[74] CDU/CSU Newsletter, 24 September 1992, B108/110688.

In Germany, however, it was agreed that "the government and the airline must continue their close coordination even after Lufthansa's privatisation to keep Germany competitive in the long term".[75] Just as in the BA case, the government intervened to negotiate a more favourable outcome for Lufthansa. In the German case, this also highlights the continuing and custodian relationship between the government and flag carrier post-privatisation. Lufthansa, however, did not wait for the 1996 bilateral agreement to develop its scale strategy. The Fischer and CDU/CSU perspective was in fact accurate to what followed for Lufthansa.

4.3.2 Scale strategy with a twist

4.3.2.1 Lufthansa versus BA strategy

The above deregulation aspects positioned Lufthansa in a similar context to BA and the rest of the industry. It inspired Lufthansa to adopt the scale strategy for its future. Indeed, it has been previously noted that Lufthansa under Ruhnau already endorsed the scale strategy rhetoric. However, it wasn't until Weber that Lufthansa adopted specific steps. Yet this came with a slight twist for Lufthansa compared to BA.

Unlike BA, Lufthansa effectively bypassed the investment period in other airlines to focus directly on code-sharing agreements with strategic airlines. Weber knew that this approach was, to some extent, odd compared with that of the BA early stake acquisitions:

> We are building a global partnership without equity investment or cross-ownership of shares. The future will show if BA has made a mistake. I think they are saddling the horse from the back.[76]

With the benefit of hindsight, Weber's assertion can now be answered. Neither approach was right or wrong in the context of the time. Lufthansa was in a situation where the pressures of the single aviation market were already a reality. Fostering acquisitions would take time and effort during a period of immediate threat and privatisation planning. In 1990, Lufthansa already attempted to acquire a 25% stake in Interflug. However, this acquisition was blocked by the German Federal Cartel Office on antitrust grounds.[77] Left without a domestic acquisition, code-sharing was the optimum strategy given these constraints. As the study will present, this strategy intensified during the Star Alliance

[75] Jürgen Weber and Franz Müntefering, 1998-99 Transport Minister, in Der Lufthanseat, 18 December 1998.
[76] Weber, interview in the UK Observer, 11 September 1994.
[77] Reuters, *East German Airline Closed*, 9 February 1991.

formation. In comparison, BA had more time during the late 1980s and early 1990s to foster partnerships and cross-investment. BA was also better able to put pressure on its government for the BCal takeover. It is, nonetheless, important to note that Lufthansa later pursued airline acquisitions during the Lufthansa Group mergers as a response to the AF-KLM merger, thus further consolidating the European airline market and exemplifying the consolidation stage of the "3C's" deregulated industry configuration. The Lufthansa Group is discussed later in this section.

4.3.2.2 Code-sharing partnerships

Even before Lufthansa reached full privatisation, there were several code-sharing partnerships established (Table 4.8).

Table 4.8 Lufthansa code-sharing partners by year, region, and code-sharing purpose.[78]

Date	Airlines	Region	Code-sharing purpose
1993	United Airlines	North America	Develop transatlantic services/ Gain wider access to U.S. market
1995	Thai Airways	Oceania/Asia	Develop partnerships in Asia/ Coordinate services in the South Pacific with United
1996	SAS	Europe	Develop extensive European network to include Northern Europe
1996	Adria Airways	Europe	Develop network to Central and East Europe
1996	South African	Africa	Develop route network to the African continent/ Offer daily routes between Johannesburg and Frankfurt/Munich
1997	Singapore Airlines	Oceania/Asia	Develop Singapore as a key hub to Southeast Asia/ Increase flight frequency between Frankfurt and Singapore
1998	All Nippon Airways	Oceania/Asia	Consolidate presence in East Asia/ Increase flight frequency between Frankfurt and Tokyo

The table above highlights the extensive reach of Lufthansa's code-sharing. Like BA, Lufthansa understood that partnering with a U.S. mega-carrier was essential to surviving the

[78] Der Lufthanseat, 1993-98 announcements.

transatlantic competition, but also to acquiring further access to the U.S. market by means of connecting flights. The partner of choice was United, one of the U.S. Big Three. Between 1993-94 Lufthansa and United agreed to code-share on hundreds of weekly transatlantic flights and pool frequent miles credits between the two. Once again, government custodianship was present as the code-sharing agreement was established only after approval from the German and U.S. governments in April 1994.[79] Stephen Wolf, the United chairman, shared Weber's sentiments on the importance of this partnership:

> In the present political and economic reality, no single carrier will in the future command the resources needed to meet market needs.[80]

The same logic applied to Lufthansa's new Asian partnerships. The code-sharing with Thai, Singapore, and All Nippon Airways signalled an interest in consolidating Lufthansa's historic presence in the region. Concomitantly, this interest extended to increased flight frequency between Frankfurt and Tokyo, Singapore, and Bangkok. The code-sharing with Thai and United was especially advantageous toward connecting routes and forming a South Pacific network. Lufthansa was proud of this three-party early network, naming it the "World's Largest Airline Alliance":

> Our global alliance with United and Thai is larger than British Airways-USAir-Qantas in terms of scheduled international passenger traffic.[81]

In Europe, Lufthansa presence has been historically the strongest for the airline. Nonetheless, Lufthansa saw opportunity to further develop its access to Scandinavia through the SAS agreement. Central and East European flight frequency between Ljubljana and Frankfurt/Munich were also extended by code-sharing with Adria Airways. The code-sharing with South African came as a result of increased demand to Johannesburg in the wake of the peaceful political transition under Nelson Mandela, but also due to Johannesburg's potential as a gateway to the rest of the continent.

Code-sharing laid the groundwork for the establishment of the world's first multilateral and largest airline alliance.

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[79] Lufthansa, Preliminary international offering circular, 18 August 1994, B126/146288, (Koblenz: Bundesarchiv).
[80] Stephen Wolf, United Chairman, in Der Lufthanseat, 5 October 1993.
[81] Der Lufthanseat, 16 December 1994.

4.3.3 Star Alliance and the Lufthansa Group, 1997-2007

4.3.3.1 Star Alliance

Lufthansa, like BA, developed its code-sharing into the eventual formation of the Star Alliance. The alliance was officially launched on 14 May 1997. Yet this special arrangement once again needed approval from governments. The U.S., German, and EU sides gave their approval for the establishment of the alliance. This was allowed to proceed through the granting of antitrust immunity, meaning that the airlines would commit to establishing a wider network of connections in exchange of legal immunity to collude on services and advertising. In summary, competition was sacrificed to some extent in these alliance situations for the sake of cooperation and consolidation. In this sense, Lufthansa and the formation of Star Alliance are representative of the "3C's" framework in the same manner as BA was with the establishment of Oneworld. The founding Star Alliance members were Lufthansa, Air Canada, United, Thai, and SAS. Table 4.9 portrays the early Star Alliance members.

Table 4.9 Star Alliance members, date joined, region, and ownership at joining, 1997-2000.

Date Joined	Airlines	Region	Ownership (at joining)
1997	Lufthansa	Europe	100% private
1997	Air Canada	North America	100% private
1997	United Airlines	North America	100% private
1997	Thai Airways	Oceania/Asia	51% public
1997	Scandinavian Airlines	Europe	50% public
1997	VARIG (Rio Grandean)	South America	100% public
1999	Ansett Australia	Oceania/Asia	100% private
1999	Air New Zealand	Oceania/Asia	100% private
1999	All Nippon Airways	Oceania/Asia	100% private
2000	Austrian Airlines	Europe	52% public
2000	Singapore Airlines	Oceania/Asia	55% public
2000	British Midland	Europe	100% private
2000	Mexicana	South America	51% private

The scale strategy and the intention to expand the alliance was also communicated by Lufthansa to Waigel:

> […] Lufthansa will have to face up to the fierce international competition with all the means at its disposal. The alliances which Lufthansa has entered into and will continue to enter are a decisive instrument for improving its competitiveness. These presuppose mutual recognition of the frequent flyer programmes as an essential connecting element, having the integration of the programmes as an agreed goal. The customer loyalty achieved through frequent flyer programmes is an indispensable instrument both for Lufthansa and for its alliance.[82]

Indeed, the harmonisation of frequent flyer programmes is a common element toward the creation of a worldwide network. Like BA and Oneworld, Lufthansa and Star Alliance frequent flyer programmes included benefits such as priority boarding, preferential access to lounges, extra baggage allowances. These were divided within Gold and Silver loyalty packages based on the number of miles flown.

As seen in Chapter 3, Star Alliance has historically ranked as the largest alliance in terms of international traffic since its formation. While the prime mover benefits apply here, the early success of Star Alliance was also due to what Lufthansa management termed a policy of "accelerated consolidation".[83] Airlines were quickly integrated within the alliance with the aim of targeting all main regions early on. This is evident in Table 4.9, above. Furthermore, Star Alliance also developed a numbers advantage compared to the later establishment of Oneworld and SkyTeam, both of which began operating with fewer members than Star Alliance. For example, by the time of Oneworld's first addition of Finnair in 1999, Star Alliance membership was already situated at 6 members, with 3 more joining in 1999 alone. Quick harmonisation of flyer programmes was also made a priority in this context. Lufthansa was aware that this quick consolidation would have to remain a priority:

> In size and structure, the alliance has indeed taken us out front in the industry. But we will not automatically retain that lead. Other major alliances, take BA and American Airways, are emerging or being built up. We cannot afford a breather,

[82] Wolfgang Röller, chairman of the Lufthansa supervisory board, private letter to Theo Waigel, 8 July 1996, B108/132014, (Koblenz: Bundesarchiv).
[83] Der Lufthanseat, 4 August 2000.

> quite the opposite: We must work even harder to hold on to our advantage. It's like any race or sport–they all pursue the leader.[84]

And this is indeed what Lufthansa and Star Alliance did. The alliance expanded rapidly during 1999-2000, to welcome no more than 7 new partners, the largest alliance additions within a 2-year timeframe as of 2023. With the success of Star Alliance and the establishment and consolidation of the first truly worldwide network, Lufthansa pursued further consolidation by means of acquisitions and mergers.

4.3.3.2 Lufthansa Group mergers

As with previous crises, the 9/11 crisis exposed the weaknesses of ailing airlines. However, it highlighted that flag carriers like Lufthansa were also not immune to its effects (Table 4.5, above). This aspect alongside the rise of LCC competition made Lufthansa rethink its former strategy of not pursuing acquisitions. In 2001, Lufthansa acquired a 25% stake in Eurowings and its Germanwings subsidiary, an LCC airline with a focus on the European market. The formation of a Lufthansa Group was taking shape as Lufthansa took full ownership of Eurowings in 2011.

The 2004 AF-KLM merger signalled further consolidation within the European market. The details of this event are discussed in the following chapter. However, this important development determined Lufthansa and BA to pursue mergers as well. The new 2003 Lufthansa chairman Wolfgang Mayrhuber, Weber's successor and former Lufthansa technical manager with over 40 years experience at the airline, intensified the acquisition policy.

Swiss Airlines was welcomed into the Lufthansa Group in 2005, with the full takeover being realised in 2007. In 2009, Lufthansa acquired a 45% stake in Brussels Airlines, with the rest of the takeover completed in 2017.[85] Austrian Airlines was also bought in 2009 after experiencing financial problems. All these airlines continued operating under their own brand. They were also incorporated within Star Alliance.

Besides the new threat of the AF-KLM merger, the Lufthansa takeovers also make sense within the context of alliance re-shuffling and exiting, which was becoming increasingly common during the mid-2000s. For example, there have been airlines acquired by rivals from other alliances, but also involuntary exits due to bankruptcy. One case is Canadian Airlines, a former Oneworld member, and its buyout by Air Canada of Star

[84] Friedel Rödig, Star Alliance Executive Vice-President, interview in Der Lufthanseat, 25 July 1997.
[85] Reuters, 28 December 2016.

Alliance in 2000. Another case is Mexicana's 2004 departure from Star Alliance to re-orient its partnership from United to American Airlines, a Oneworld member. In 2006, VARIG, the former Brazilian flag carrier, exited Star Alliance after declaring bankruptcy.

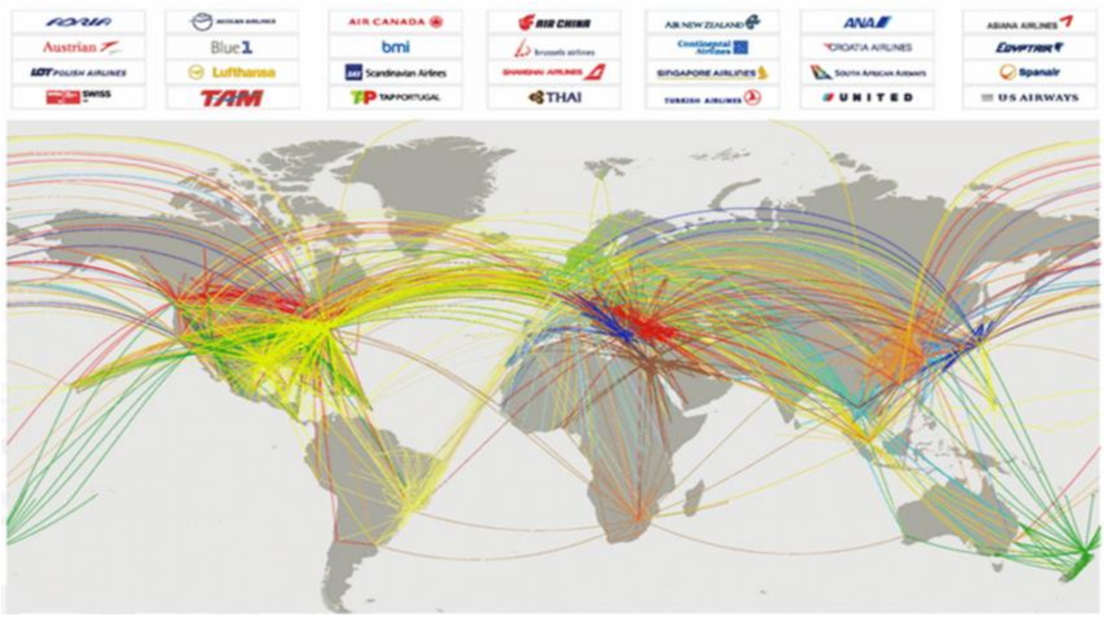
The consolidation of the Lufthansa Group and the formation of Star Alliance highlight the "3C's" framework in the same manner BA and Oneworld did. In the next chapter, this study shows that AF and its SkyTeam alliance ultimately followed this framework as well.

4.3.4 Alliance enlargement and new crises, 2007-2022

4.3.4.1 Star Alliance expansion

Star Alliance membership has increased over the years. Between 2000-07, USAir, TAP Portugal, Asiana, and LOT joined the alliance. There was a more pronounced increase after the 2008 Great Recession as a means of weathering the crisis. Major airlines, including Air China, Turkish, Egyptair, and Continental joined between 2007-09. By 2010, Star Alliance continued expanding and incorporating the widest network among the three alliances, a title it has since maintained, despite later exits by USAir and Continental from the alliance (Picture 4.9).

Picture 4.9 Star Alliance 2010 network map.[86]



[86] Courtesy of Continental Airlines, former Star Alliance member, presentation to the U.S. Securities and Exchange Commission, 15 September 2010.

As shown in Table 3.10 from Chapter 3, Star Alliance accounted for more than 23% of total market share by passenger revenue by 2006. Since 2014, however, there have been fewer members joining as the alliance market reached a consolidation point. Nonetheless, there have been recent discussions between Lufthansa and ITA throughout 2022 for the acquisition of a 40% stake in the state-owned Italian flag carrier.[87] It is conceivable that ITA would be incorporated within the Lufthansa Group and Star Alliance if this deal materialises. Importantly, ITA would also potentially leave the rival SkyTeam alliance in this case, adding to the strength of Star Alliance. However, the negotiations are likely to be lengthy given that ITA is in the process of privatisation planning.

4.3.4.2 COVID-19 and government involvement

As in the case of BA, the COVID-19 crisis exposed the custodian relationship private flag carriers continue to have with their governments. For Lufthansa, this came in the form of the largest European bailout of 9 billion Euros from the German government. This was meant to rescue the airline, but also protect it from hostile takeovers given its precarious condition. At the onset of the crisis, the Lufthansa supervisory board chairman Karl-Ludwig Kley, Mayrhuber's successor, revealed the dire situation to the Lufthansa board:

> We have no more money. We are living from the reserves we set aside. Without support, bankruptcy looms in the next few days.[88]

Compared to BA aid, however, the Lufthansa bailout involved more direct government action. The German state acquired a 20% stake in Lufthansa. The EU allowed this involvement, relaxing its rules on state aid for Lufthansa and other airlines, including AF. However, the EU permitted this deal in exchange of Lufthansa renouncing landing slots at its Frankfurt and Munich hubs. The German government also promised that it would resale the stake.[89] Nonetheless, this agreement attracted criticism from airlines, specifically non-flag carriers and LCCs like Ryanair. These airlines did not enjoy historic ties with a government to benefit from a safety net the same way that flag carriers did. Ryanair CEO Michael O'Leary argued:

[87] Reuters, 22 January 2022.
[88] Deutsche Welle, *Lufthansa bailout accepted by shareholders*, 25 June 2020.
[89] Deutsche Welle, 25 June 2020.

> How can airlines like Ryanair, easyJet and Laudamotion be expected to compete with Lufthansa now that it has €9 billion worth of subsidies?[90]

Indeed, the German government resold the shares on 13 September 2022, ahead of the proposed deadline of October 2023.[91] This sale was done with the help of Deutsche Bank and Goldman Sachs, who returned to act as lead coordinators and consultants.[92] The 20% stake sale brought the German government 1.07 billion Euros.

The Lufthansa case also exemplifies the "too big to fail" type scenario where the main participants in the industry are helped through periods of crisis, often at the expense of others by the creation of a competitive imbalance. Yet this aspect is acknowledged to some extent by the EU when the organisation asked for concessions, including renouncing landing slots, in exchange of an agreement.

Importantly, the BA and Lufthansa examples highlight the continued involvement of the government with their flag carriers even after privatisation. The study shows in the following chapter that AF also benefited from this type of relationship after its sale, albeit in an even more direct manner.

4.4 Conclusions

This chapter has examined the Lufthansa privatisation processes. In the same manner as the previous chapter, this chapter has also considered the industry dynamics behind the privatisation and post-privatisation period. The following have been revealed:

- In terms of industry dynamics behind the firm, Lufthansa saw BA as an example for its rationalisation programme. In this sense, Lufthansa eventually followed similar steps despite different early obstacles to privatisation. Lufthansa also cut expenditure, routes, reoriented transatlantic operations, among other planning. Because of privatisation, Lufthansa employees also became shareholders in the airline like BA. A strategy of scale was pursued by Lufthansa post-privatisation which bypassed the investment period and focused on code-sharing, unlike BA. This was during the 1990s period of already pronounced competition. Nonetheless, Lufthansa revisited this approach later during the early 2000s in the context of mergers. In terms of industry wide dynamics, Lufthansa was also a key actor in establishing Star Alliance and the Lufthansa Group mergers as the

[90] Deutsche Welle, 25 June 2020.
[91] Reuters, *German government sells remaining Lufthansa shares*, 14 September 2022.
[92] Reuters, 14 September 2022.

prime mover. In this sense, Lufthansa also contributed to the cooperation and consolidation of the industry, representing a prime example of the "3C's" framework. A convergence of strategies can then be observed between Lufthansa and BA in the post-privatisation period.

- Because of early obstacles like privatisation opposition within and without from political opponents and Lufthansa employees, the flag carrier took a different more gradual approach to privatisation compared to BA. This is termed as passive privatisation. Active privatisation through IPO flotation was the latter choice of privatisation once opposition subsided and European deregulation became more apparent and increasingly endorsed by the EU.

- The German state maintained a pronounced presence during nationalisation, privatisation planning, and since flotation in a similar way to BA. Unlike the UK, the German government did not endorse an ideological or even economic motive for the Lufthansa sale. A practical third way was chosen instead by renouncing control of profitable candidates that were best run by private ownership. Lufthansa is a principal example of this approach. Crucially, the state helped Lufthansa by solving the VBL issue. This allowed the Lufthansa privatisation to proceed without the risk of financial troubles at the airline. The government assumed a custodian role post-privatisation by helping the Lufthansa strategy in bilateral negotiations, especially those with the U.S.. More recently, the COVID-19 crisis reconfirmed that the relationship between flag carrier and government continues. The German government helped Lufthansa with the largest European bailout for an airline, and by taking back a minority share in the airline. While this stake has been resold, there continue to be questions about whether the ongoing relationship between government and private flag carrier represents an imbalanced "too big to fail" type scenario.

- Here too the study notes the role of consultancies in staging a similar IPO flotation to that of BA. The IPO was the method of choice for Lufthansa. Similar international consultancies have assumed a principal role in the sale, including banks like Goldman Sachs and Kleinwort Benson as underwriters. These international consultancies have specialised in this type of privatisation expertise.

> By advertising their specific expertise to other airlines as well, these consultancies propagate similar approaches to flotation.

The following chapter examines the privatisation processes behind AF. AF is one of the most recent major European carriers to experience privatisation. Unlike BA and Lufthansa, however, AF has not been fully privatised due to various reasons, including political ambivalence. Nonetheless, AF also took BA as a privatisation example, eventually following similar rationalisation steps.

Chapter 5. Air France

AF, the historic French flag carrier, represents a latecomer to the airline privatisation process. AF is the last of the privatisation case studies explored in this study. Unlike BA and Lufthansa, AF was not officially set for privatisation until 1993. Yet, management changes, substantial operating losses, and political intervention pushed the flotation dates to 1999 and 2004. By this time, both BA and Lufthansa were already fully privatised and involved in developing their alliances. However, AF has not been fully privatised unlike the other two owing to strategic ownership and political ambivalence. Importantly, the European single market was already a well-established reality with more immediate consequences for AF. While AF was also late to form SkyTeam in 2000, the last of the major three alliances to be founded, it was nonetheless the first to establish a merger with another key European flag carrier, KLM. This merger contributed to the second *de facto* privatisation of AF through government share dilution. As seen in previous chapters, the 2004 AF-KLM merger was met with replies from BA and Lufthansa via their own mergers. This had the effect of further consolidating the European airline market.

This chapter is structured differently from the previous ones for several reasons. Most of the major AF developments occurred during nationalisation. Moreover, due to its latecomer status, AF did not wait for privatisation to be completed before embarking on its scale strategy, code-sharing, and alliance formation. This was because of the pressures of the single market. As such, this chapter considers developments before privatisation, during recovery and the first partial sale, and around the second sale including developments beyond this. The timeframe explored is between 1986-2014. Most recent developments are also highlighted.

AF is worth considering due to the following:

- AF is the latecomer to the privatisation process of the three. As a result, there has been a different succession of events in terms of its strategy, where waiting for privatisation to happen was not possible. Nonetheless, this study highlights that

AF still shared similar elements with BA and Lufthansa in terms of rationalisation, scale strategy, and alliance formation.

- Unlike BA and Lufthansa, AF has never been fully privatised. While the French state's ownership decreased in 1999 and 2004, the latter of which signalled a change to minority ownership, the government has kept a strategic interest in its flag carrier. As noted in this chapter, government changes and discontinuity allowed this configuration to be present despite early general rhetoric of full privatisation. If BA benefited from the long-term planning continuity of the Thatcher governments and Lufthansa the leadership of the Kohl chancellorships, AF had to endure the policy ambivalence of a socialist government. This exposed the partial unwillingness of the French government to completely divest from AF. Nonetheless, that unwillingness has endured to this day due to strategic priorities.

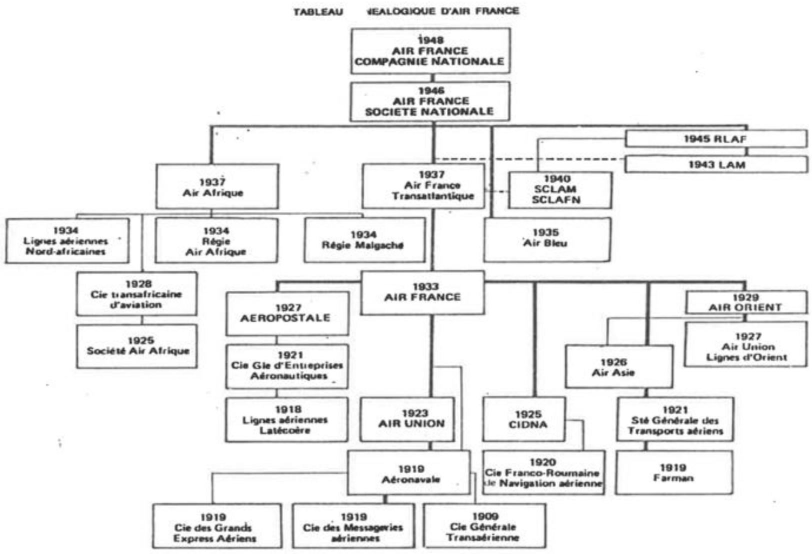
- AF encountered pronounced losses in the early 1990s which threatened its existence. The French government intervened to save AF with a substantial bailout to the criticism of BA and Lufthansa. Decades later, the French government intervened with a bailout once more in the context of the COVID-19 crisis. The AF example reconfirms the special long-term relationship between flag carrier and its government despite privatisation.

- The French government's early motivation for its 1980s-1990s privatisation programme was extending share-ownership. While this was informed by the success of the UK, this ideology was not further explored. For example, AF was not fully privatised. Different governments also backtracked on this ideal by opposing full privatisation. Nonetheless, the French government was more vocal than UK and Germany about using privatisation as an instrument for reducing the rising 1980s state debt.

- Despite pursuing its scale strategy while under nationalisation and during privatisation planning, AF also fits within the "3C's" industry framework.

AF was formed in a similar manner to BA—through airline mergers. The French flag carrier had its origins in several privately owned airlines which had built an extensive network to French colonies and beyond before the Second World War. However, the pressures of the 1930s Great Depression and the desire of the French government to restructure the industry resulted in the formation of Air France in 1933 (Picture 5.1).

Picture 5.1 Air France early genealogy, 1909-48.[1]



The establishment of AF also had the aim of consolidating the already extensive network formed by the previous airlines under one major flag carrier for commercial, and later for national interests. The importance of AF and airline services to national interests became especially evident when the French government nationalised the airline and its entire air transport industry after 1945, effectively taking control of the largest flying network in the world at the time.

In the 1950s, AF was also favourably positioned to expand to other markets, such as the New York-Paris service given new bilateral agreements with the U.S.. This "Golden Age" for AF is notable as the flag carrier had state-backing and no competition in domestic markets. Internationally, it was also a top performer when judging AF based on its widespread network. Its extensive network also meant that 90% of its traffic came from international routes by the early 1960s.[2] The arrival of wide-body aircraft opened new markets and capacity increases meant that mass air travel was now becoming a possibility. As a result, AF was swift to start operating the new Boeing 747 long-haul wide-body aircraft,

[1] Air France, internal document, 14 September 1987, Édouard Balladur Files, B-0074089, (Savigny-le-Temple: Le Service des Archives Économiques et Financières, SAEF, 1986-88).
[2] Musée Air France, *The history of Air France*, (Paris: Musée Air France, various years).

being among one of the earliest adopters. In 1976, AF introduced the (in)famous Concorde into service, which later operated at a loss for both BA and AF (Picture 5.2).

Picture 5.2 Air France Concorde test flight, 1973.[3]

In 1983, the French flag carrier celebrated 50 years since its formation. The success of AF for the domestic economy became apparent—it was the fourth airline in the worldwide in terms of the number of passengers carried.[4] New routes were also opened to Asia, including South Korea. The latter half of the decade saw AF being subjected to more competition as a result of the general drive for open markets across the continent. The French government opened routes for competition to break the monopoly of AF and aid its French rivals Union Aéromaritime de Transport, a private airline founded in 1963, and Air Inter, a semi-public domestic airline founded in 1954. As later explained, this was short-lived and ultimately reversed. The formation of the European single market made AF face its most challenging period.

5.1 Developments before privatisation, 1986-93

This section explores the motivations behind the French privatisation programme, the state of AF and its strategy, the financial crisis at the flag carrier and the subsequent steps to recovery. This section highlights that AF was faced with operational issues, which necessitated government involvement and aid. Privatisation was briefly considered, although only a few steps were taken at this time given the crisis at AF.

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[3] Air France, Bulletin No. 7, September 1973, Air France Corporate Archives, Secretary General Documents, AN 20180302/199, (Pierrefitte-sur-Seine: Archives Nationales de France, 1920-2003).
[4] Der Lufthanseat, Lufthansa staff newspaper, August 1982, (Cologne: Lufthansa Archives), p. 6.

5.1.1 AF and the state during the second Chirac government and beyond, 1986-1990

5.1.1.1 Motivation to privatise

In 1986, the Socialist Party rule was replaced with the liberal right-wing Rally for the Republic party. This was led by the premiership of Jacques Chirac. Unlike its former traditional Gaullist roots of economic dirigisme, the Rally for the Republic party and the Chirac government policies marked a departure from the conventional by transferring power and responsibility to the private sector. Influenced by the same deregulation current as the one sweeping across Western Europe at the time, the Chirac government announced a general privatisation programme to be started in 1986.

This effort was led by Chirac's right-hand man Édouard Balladur, the newly appointed Economic and Finance Minister, and future French Prime Minister. Balladur can be regarded as the leading figure behind the privatisation programme and his thoughts on the matter highlight the motivations behind the process. Balladur's approach to privatisation was, in most respects, similar to the UK. Balladur and the French government endorsed privatisation as a vehicle for what they termed "popular shareholding" as decided through "economic democracy" by taking part in the flotation process:

> I believe we will only become a modern country when there are millions of shareholders and the French take interest in their companies.
>
> This is what I call popular shareholding and I am very attached to it, because I see it as one of the means of changing our society.
>
> We must pay tribute to this action [liberalisation of financial markets ahead of the 1992 EU Single Market], which is also the subject of a broad consensus in our country. France has finally adopted the same rules of the economic game as those that have proved successful elsewhere.[5]

These approaches attracted attention from the press, often being compared to the UK rhetoric of the time. Balladur admitted this:

[5] Édouard Balladur, interview at HEC Paris, 18 September 1986, Édouard Balladur Press Releases 1986, SAEF B-0066332; Balladur, interview at Radio Monte-Carlo, 1 June 1987, Édouard Balladur Press Releases 1987, SAEF B-0066331; Balladur, conference speech at European Finance 1992 Forum, 5 March 1987, SAEF B-0066331. All French to English translations throughout the chapters are the work of the author of this study.

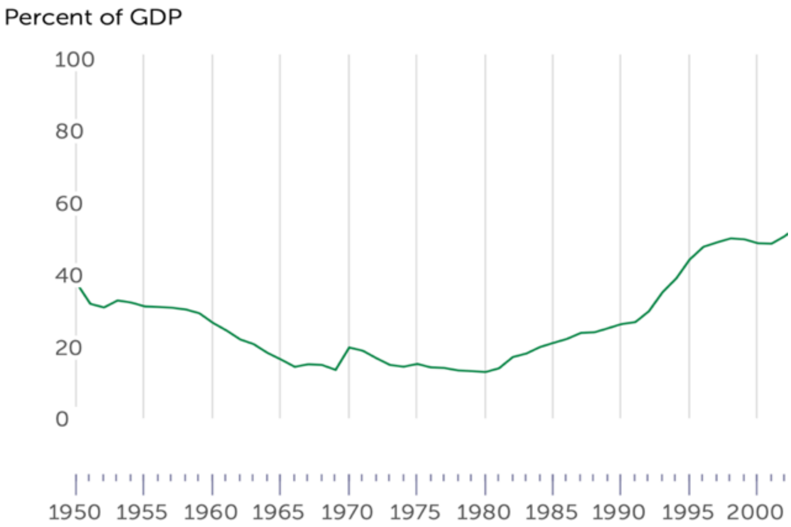
[The press] compare us to Mrs. Thatcher. My colleagues in the government say to me: Yes, but she wins elections! (laughter)

I prefer less privatisation and full privatisation to more privatisation and partial privatisation. I am not a supporter of mixing genres.[6]

Indeed, the French government advertised a very definite form of divestment, like the UK. And for the early part of the programme up until 1990, this was true given the full divestures from financial institutions like Paribas and Société Générale. It was argued that mixed ownership was an ineffective form of management and would diminish the purpose of privatisation. However, AF did not later fall into this advertised aim. Unlike BA and the UK government, the French government did not eventually achieve a full divesture with AF. The reasons for this are discussed later in this chapter.

The French government was also more forthcoming about the economic aspects of privatisation compared to the UK. France was faced with rising debt in the 1980s after the oil crises of the 1970s (Figure 5.1).

Figure 5.1 French government debt as percentage of GDP, 1950-2000.[7]



Balladur and the government saw privatisation as an instrument for debt reduction and support for other public companies:

[6] Balladur, press statement, 18 June 1987, SAEF B-0066331; Balladur, press statement, 29 July 1986, SAEF B-0066332.
[7] International Monetary Fund, Central Government Debt Database, 1950-2000.

> Our objective is to obtain a debt reduction thanks to the proceeds of privatisation, which you know I have decided to allocate as a priority to reducing state debt.
>
> Half of the revenue from 1988 privatisations will be allocated to public companies, in particular to the autonomous ports, CDF-Chimie [chemicals], Thomson [aerospace and defence], and the steel industry.[8]

Indeed, by 1988 the government privatised 30 of the planned 65 state companies of the first French privatisation wave, representing companies with a total value of 120 billion francs. Over 5 million new individual shareholders took part in this first French privatisation wave, along with 500,000 French civil servants turned employees and shareholders in the companies they worked for.[9] In this sense, the status of the French civil servants was also changing as a result of privatisation in the same manner as those present in the UK and Germany.

Yet AF was not included in this first wave. This was because it was believed that companies already within competitive industries were not a privatisation priority at this time. Balladur replied:

> Our programme does not aim at privatising companies such as Air France, for example, which belongs to the competitive sector, or CDF-Chimie, which also belongs to the competitive sector.
>
> There will be many competitive companies left to privatise, even when we have finished our task, or others. I repeat, Renault, Air France, Air Inter, all that, the steel industry, CDF-Chimie, and many others which I don't think of, there will still be several tens of billions left to sell.
>
> [On AF privatisation] I've given my agreement in principle to the idea. We are studying it. I don't have a proposal yet.[10]

Indeed, the government privately considered a 300 million francs capital increase in November 1987 through a 10% government share offer. AF employees would have been

[8] Balladur, press conference in Milan at the Italian Chamber of Commerce and Industry, 27 April 1987, SAEF B-0066331; Balladur, in France-Presse, 18 April 1988, SAEF B-0066332/2.
[9] Balladur, interview in Caveau de Provins, 14 March 1988, SAEF B-0066332/2.
[10] Balladur, interviews with Radio France, 17 and 26 May 1987, SAEF B-0066331; Balladur, press statement, 18 June 1987, SAEF B-0066331.

allocated 10% preferential shares of this proposed sale.[11] This initial capital opening was considered by Balladur and the rest of the government to be the start of future AF privatisation rounds.[12] Yet, privatisation would not materialise anytime soon as this plan was ultimately scrapped in favour of abiding by the already pre-determined first privatisation wave programme. As a result, the government stake in AF would not change until the early 1990s (Table 5.1).

Table 5.1 French government main ownership changes in AF.[13]

Year of Change	Government Ownership	Explanation
Before 1991	99%	1% dedicated to the Deposits and Consignments Fund*
1991	91%	Banque Nationale de Paris 8.8% stake buy
1999	54%	First partial privatisation
2004	44%	Second privatisation and merger with KLM
2019	14%	Reductions over time
2021	30%	COVID-19 bailout stake buy-back

5.1.1.2 The state of AF and acquisitions

Despite a lack of progress related to the AF privatisation, the flag carrier, nonetheless, experienced a favourable situation in terms of operations by 1986 (Table 5.2).

Table 5.2 Air France 1986 Operating Results.[14]

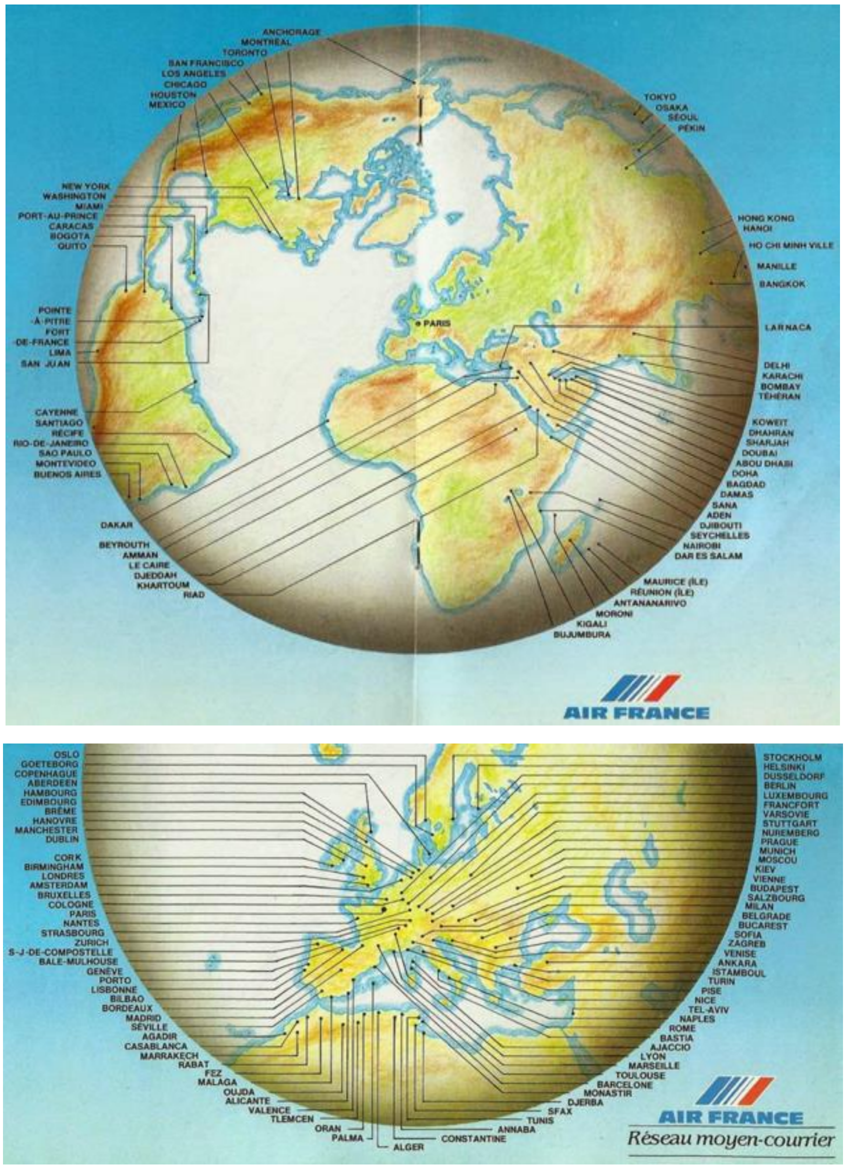
Operating Results	Data
Net Profit	677 million francs
Autofinance Capability	2,625 million francs
Employees	35,269
Fleet	108 aircraft
Traffic Increase in the Last 6 Months	13.7%

[11] Crédit Lyonnais bank, *Air France Capital Opening*, 16 October 1987, Stock Market Operations files, Archives Nationales AN 20040210/20.
[12] Jean-Marie Messier, Economy Ministry privatisation counsellor, report to Balladur, 5 August 1987, Economy Minister Privatisation Finances files, Archives Nationales AN 20010172/24.
[13] Correspondances de Air France, shareholder newsletter, Air France-KLM merger, September 2003, reprinted by the U.S. Securities and Exchange Commission, Air France Form 425; Euronews, *EU approves €4 billion aid to Air France, with strings attached*, 6 April 2021.
* The Deposits and Consignments Fund (Caisse des dépôts et consignations) is the public investment and financial management institution which oversees the development and management of aspects like pensions, investments, and saving funds at publicly owned enterprises.
[14] Air France, internal document, 14 September 1987, SAEF B-0074089.

Number of Countries Served	77

The AF net profit for the rest of the 1980s looked as favourable: 1,221 million francs in 1987 and 1,152 million in 1988.[15] As seen in Chapter 3 Table 3.4, AF also compared on equal terms with the European TE average, but trailed the top-performer BA. Its route map was nonetheless among the most developed, encompassing the major continents (Picture 5.3).

Picture 5.3 Air France 1986-87 long-haul (above) and European medium/short-haul routes (below).[16]



15 Jack Eaton, "Air France's Strategic Plan: Benevolent 'New Despotism'?", *Work, Employment & Society*, Vol. 7, No. 4, December 1993, pp. 585-602.
16 Air France, timetable 26 October 1986, courtesy of Airline Memorabilia, copyright belongs to Air France. Found at: https://airline-memorabilia.blogspot.com [Accessed 1 December 2022].

In 1988, Bernard Attali was appointed as the new AF chairman (Picture 5.4). Attali is the brother of Jacques Attali, a close counsellor to President François Mitterrand. While Bernard Attali was a director with extensive experience of financial and territorial development, he had no direct connections with the airline industry prior to running AF.

Picture 5.4 Bernard Attali, AF chairman, 1988-93.[17]

Far from being discouraged by his limited expertise, Attali pursed an aggressive strategy from the onset. This extended to a five-year fleet renewal programme. Orders were placed for 19 Airbus A320, 7 Airbus A340, 2 Airbus A310-300, 16 Boeing 747-400, 12 Boeing 737-500, and 3 freighter Boeing 737-200.[18] Flight frequencies were increased for transatlantic destinations like San Francisco, Boston, and Miami. European service frequencies were also increased. In Asia, daily flight frequency was increased on the Paris-Tokyo service. However, this late 1980s expansion planning incurred large amounts of borrowing, followed by the accumulation of long-term debt. Attali stated:

> We shall have to spend more than 65 billion francs to finance our investments and repay our loans over the next ten years, 24 billion of which must be repayed in the next three years alone...and these billions will not fall from the sky...these will have to come, for the most part, from our annual results, from our efforts...[19]

[17] Copyright belongs to Gérard Fouet/France-Presse, unknown year.
[18] Air France, *Service de l'Information*, 15 March 1989, Air France Corporate Archives, Archives Nationales AN 20180302/214.
[19] Bernard Attali, interview in *Air France: Une Grande Ambition*, Air France Info internal newsletter, 24 May 1989, Archives Nationales AN 20180302/204.

Attali's more authoritarian statements gathered the attention of the press, but his aggressive strategy must be considered into context.[20] Attali and AF were in a situation where its main competitors BA and Lufthansa were already privatised or in the process of privatisation. BA and Lufthansa were also preparing for the European single market and U.S. competition. Attali was rightfully worried about the looming perils of deregulation, especially after the enactment of the First and Second European liberalisation packages in 1987 and 1990, respectively. Compared to BA and Lufthansa, he offered the most striking speech on European deregulation:

> "1993" is neither a myth nor an invocation intended to frighten. "1993" will concern our daily lives. "1993" will mean British Airways continuing its London-Paris service to Rome and, why not a little later, to Marseille and Nice. "1993" will also mean Air France on Frankfurt-Copenhagen or Frankfurt-Hamburg. "1993" will be a powerful group acquiring a company which has not made the necessary effort to prepare for the fight. "1993" will be one or more new entrants who will propel themselves, as was the case in the United States, to the forefront of the scene...
>
> *We must be clear: Europe is a fact!*
>
> I don't like to cultivate an apocalyptic tone. When it comes to air transport, I am not a fanatic of all-out liberalism... That being said, Europe is a fact, Europe is overtaking us. And we all have to face reality...
>
> Air France is not nothing. But a clear-sighted and mobilised Air France is even better... There can be no slacking off in terms of competitiveness... It is vital, in the face of our competitors, to do everything possible to rigorously monitor the evolution of our costs...[21]

As a result of this rallying cry to AF employees, AF and the government sanctioned an immediate scale strategy, similar to that of BA-BCal, via takeovers. Unlike Lufthansa and Germany, the French government did not seek to foster domestic competition. Rather the main aim was to strengthen its flag carrier on the international stage. By the middle of

[20] New York Times, *Air France Chief Quits Amid Strike*, 25 October 1993.
[21] Attali, interview in *Air France: Une Grande Ambition.*

January 1990, AF took over the Union de Transports Aériens (UTA), the private and second largest French airline by traffic. UTA was an international rival to AF, connecting the French market to European destinations. At the same date, Air Inter, the semi-public domestic airline, was also acquired. Both were eventually absorbed into Groupe Air France during the 1990s. Because of these immediate takeovers, the new Groupe AF now served over 245 destinations, across 100 countries, with a combined fleet of 200 aircraft.[22] This was celebrated as giving AF "the size to compete with its biggest global competitors".[23]

However, the takeovers amounted to an extra 1.5 billion francs annual group expenses, which did not receive attention until 1993.[24] Additionally, there was little attempt to integrate UTA and Air Inter by reducing worker size or harmonising operations. These issues shortly became apparent to AF, although only after the First Gulf crisis.

5.1.2 Trouble at AF and government intervention, 1990-93

5.1.2.1 "CAP 93" failure

AF encountered its deepest post-war crisis once the First Gulf War effects of rising oil and fuel prices as well as the compounding debt were felt. To some extent, this was similar to the late 1980s Lufthansa fleet acquisition and its susceptibility to the crisis. However, this crisis was deeper for AF because of the costly acquisitions. The AF losses are summarised in Table 5.3.

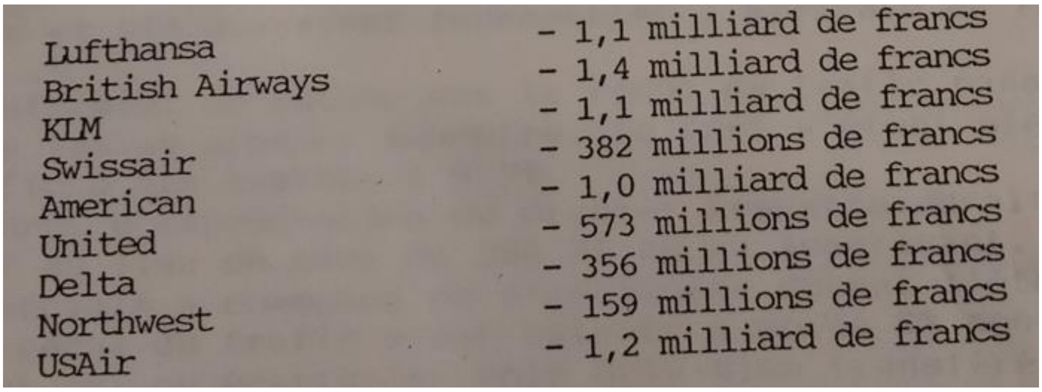
Table 5.3 AF crisis results, 1990-93.[25]

Year	Net Losses
1990	-0.8 billion francs
1991	-1 billion francs (first half)
1992	-3.2 billion francs
1993	-8.5 billion francs

[22] Air France, Bulletin No. 80, 1st trimester 1990, Archives Nationales AN 20180302/222.
[23] AF, Bulletin No. 80.
[24] Air France Info internal newsletter, *Air France launches important strategic plan, "CAP 93"*, 25 September 1991, Archives Nationales AN 20180302/204.
[25] Air France, internal communiqué, 15 October 1991, AN 20180301/86; New York Times, 30 May 1997; Les Échos newspaper, *Radioscopy of Privatisations*, 30 August 1993, Cabinet Privatisation Files 1993-95, Archives Nationales AN 19960420/3 Dossier 1; Eaton, "Air France's Strategic Plan: Benevolent 'New Despotism'?", *Work, Employment & Society*.

The situation was one of “disastrous results”, as acknowledged by French National Assembly members, the lower house of the French Parliament.[26] Losses were amounting into the billions of francs with no sign of stopping. The workforce became bloated from nearly 36,000 employees in 1986 to 63,000 employees by 1992. AF self-financing capability also plummeted. In 1994, AF was at a negative 800 million francs self-financing ability, this meant AF needed external aid to survive the crisis as it was unable to sustain its operations and repay loans.[27] Expansion was no longer viable in this situation. In equal measure, privatisation was also out of the question at this time. As portrayed in Picture 5.5, the crisis affected the entire industry.

Picture 5.5 Gulf War crisis losses at key airlines, first half of 1991.[28]



Lufthansa	- 1,1 milliard de francs
British Airways	- 1,4 milliard de francs
KLM	- 1,1 milliard de francs
Swissair	- 382 millions de francs
American	- 1,0 milliard de francs
United	- 573 millions de francs
Delta	- 356 millions de francs
Northwest	- 159 millions de francs
USAir	- 1,2 milliard de francs

In a similar manner and around the same time as Lufthansa, Attali and AF pursued a turnaround plan starting 1991. The self-entitled “CAP 93” aimed at cutting over 3,000 jobs by the end of 1993 and freezing pay, alongside with a policy of rationalising routes meant to reduce over 1.5 billion francs annually.[29] This meant layoffs instead of voluntary departures, unlike at BA and Lufthansa. Unsurprisingly, this programme failed due to intense opposition from the staff. Throughout 1991 and 1992, there were several strikes involving the majority of AF flight attendants and engineers, among others. This effectively paralysed AF, leading to a deterioration of its situation. Nonetheless, the strong-willed Attali doubled down on CAP 93:

[26] Jacques Godfrain, French National Assembly member, *Notes on the semestrial results of Groupe Air France and plans for recovery*, 10 November 1992, Philippe Séguin Files, 1993-97 President of the National Assembly (1934-2010), Archives Nationales AN 697AP/170.
[27] French National Assembly Economic Commission, internal document on the Air France situation, 1 September 1994, Archives Nationales AN 20180301/128.
[28] AF, internal communiqué, 15 October 1991.
[29] AF Info, “CAP 93”, Archives Nationales AN 20180302/204.

> The only possible way forward is to take our own destiny in hand. It is not the State that will save Air France, nor is it Brussels. It is us, and us alone.[30]

The government, however, *intervened*. It sided with the employees. Transport Minister Bernard Bosson argued that “we must have social peace, we must change plans” in the context of the pronounced French unemployment of the early 1990s.[31] In the AF case, this chapter notes the important role of the government in guiding the main developments at the flag carrier. Attali ultimately resigned in 1993. CAP 93 concluded as a failure.

5.1.2.2 New leadership and government bailout

Attali’s successor was Christian Blanc. Blanc was instated as the new chairman on the 27 October 1993. His background included working for public sector institutions. Notably, Blanc was the president of the Paris public transport company before joining AF. Similar to King and BA, Blanc took on the position with the expectation that AF would eventually become private under his leadership (Picture 5.6).

Picture 5.6 Christian Blanc, AF chairman, 1993-97.[32]

Furthermore, Blanc was tasked with redirecting AF toward recovery. This was due to the government’s aim of privatising AF as part of their newly announced 1993 second

[30] Attali, internal address to AF employees, 17 December 1992, Archives Nationales AN 697AP/170.
[31] Bernard Bosson, in New York Times, 25 October 1993.
[32] Air France, Bulletin No. 95, 4th trimester 1993, Archives Nationales AN 20180302/222.

privatisation programme.[33] This programme included AF, alongside Renault, Thomson, Elf (petroleum), Aérospatiale (aerospace and defence), among others. The Blanc recovery plan is discussed in the following section. Blanc and AF benefited from the government's intervention at the very beginning of his leadership.

Perhaps ironically, it was precisely the state that helped AF with the EU signing off on a significant bailout deal. The French government pursued a 20 billion francs (over 3 billion Euro) recapitalisation plan between 1994-96 to save AF and "buy" time for a recovery to happen. This was in addition to the November 1991 sale of 8.8% stake of AF to the semi-public Banque Nationale de Paris in the form of bonds worth 1.2 billion francs.[34] The government owned 91% stake in AF as a result.

In addition to approving the bank investment, the EU also approved the bailout. This bailout came with the condition that it would be used to redress AF for a future privatisation. Nonetheless, the EU decisions were met with widespread criticism and complaints as state aid was also granted to other flag carriers between 1993-94, including Aer Lingus, Olympic, and TAP Portugal. BA and Lufthansa decried the distortion of competition due to the AF bailout and bank investment. In the French press, the Lufthansa recovery example was discussed in contrast to AF. The question loomed as to why Lufthansa was able to stage a recovery without any state bailout, exposing managerial doubts.[35] Meanwhile, UK officials accused the EU of favouritism:

> Far from being coy about all this, Air France—perhaps sensing the Commission's basic good will—is, in a literal sense, going for broke. Rather than backing off or being shy, it has now put in for the astronomical figure of £2.47 billion in subsidy—a staggering sum in the circumstances.[36]

AF hit back at some of the accusation claiming that the successful privatisation of BA was also achieved because the British flag carrier benefited from state involvement and EU generosity in permitting its investments. As seen in chapters 3 and 4, this has been true for both BA and Lufthansa. Yet this chapter also notes a similar government involvement in AF. However, AF did not address the Lufthansa comparisons.[37] Ultimately, AF still received

[33] French Government Secretary General, *Finalisation of the Privatisation Bill*, 1 June 1993, Industry Privatisation Files (1993-95), Archives Nationales AN 19960420/3 Dossier 1.
[34] Air France Info internal newsletter No. 191, 22 July 1992, Archives Nationales AN 20180302/204.
[35] Le Monde newspaper, 10 January 1994, Archives Nationales AN 20180301/40.
[36] Hansard, *Air Traffic (Liberalisation)*, UK House of Commons, 17 March 1994, cc. 1091.
[37] The UK Guardian, *Air France hits at British Airways*, 26 July 1994.

the aid over a period of 3 years. Nonetheless, AF was still in need of a capable recovery before privatisation could proceed.

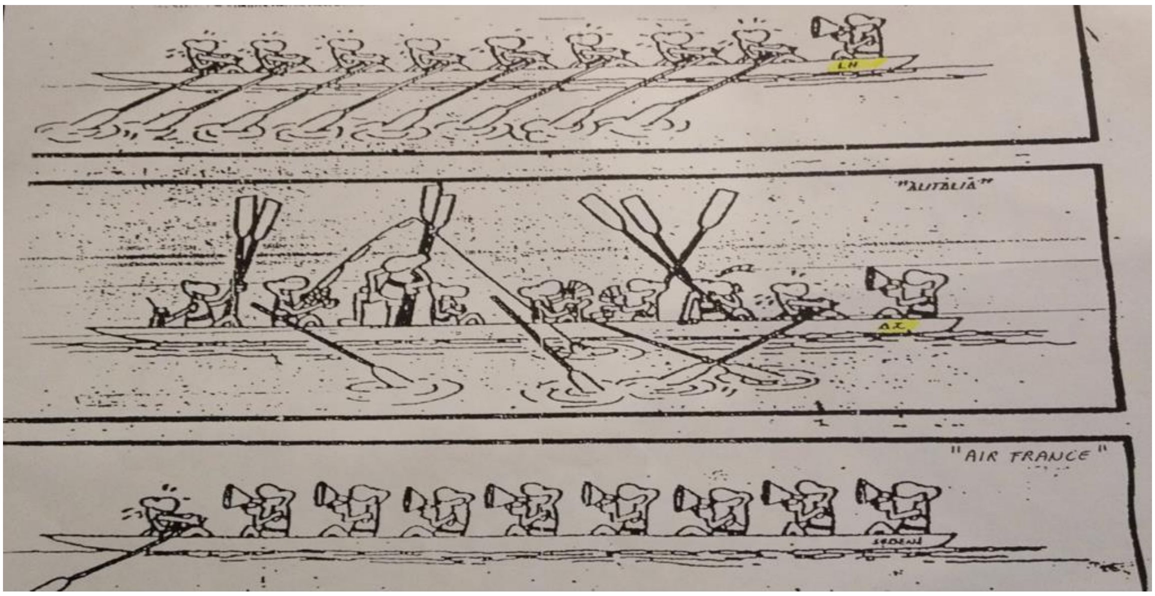
5.2 Recovery and first partial privatisation, 1994-2000

This section examines the steps AF took for recovery under the Blanc management, the code-sharing agreements realized by AF, and the political ambivalence of the Jospin government related to the AF 1999 partial privatisation.

5.2.1 "Project Rebuilding Air France", 1994-97

With Blanc as the new manager and with the safety net of the approved bailout, AF could now start amounting to a recovery, and dispel media criticism (Picture 5.7).

Picture 5.7 Parody comparison of Lufthansa, Alitalia, and AF, 1994.[38]



Entitled "Project Rebuilding Air France", the 1994 rationalisation programme proposed a slightly different approach from Attali, although waste and overstaffing continued to be the main targets. By this period, this rationalisation strategy was common among airlines in the context of the First Gulf crisis, including early 1990s rationalisation programmes at KLM and Alitalia. Blanc appealed to AF staff, mentioning the successful rationalisation plans at BA and Lufthansa as comparison:

[38] Unknown author, 1994, Archives of the Air France General Direction (1954-97), Archives Nationales AN 20180301/86. Please note that the AF boat is incorrectly named "Sabena" after the former Belgian flag carrier. Lufthansa was portrayed as a disciplined flag carrier; Alitalia is exemplified as operationally chaotic, which is backed up by its tumultuous history of losses and state interventions; AF is portrayed as a flag carrier which lacks a coherent strategy.

> For Air France to recover and find the leading role we all want for it, we have to change, and everyone knows change is not easy. We must significantly reduce our costs and increase our revenue, as British Airways, the American companies, and more recently Lufthansa have already done before us. There is no other choice.[39]

The Blanc rationalisation plan had the following steps:

First, there were 5,000 voluntary renumerated redundancies as opposed to layoffs.[40] A 3-year wage growth freeze was implemented, especially for AF pilots and cabin crew. For employees who agreed to wage reductions, these would be recompensated with discounted shares for a future floatation. Employees also had their work times increased from 38 to 39 hours per week for ground staff and from 67 to 75 hours per month for flying personnel.[41] An early retirement plan was also implemented. These measures were agreed by 81% of voting AF staff.[42]

Second, cost-cutting was also implemented through harmonisation of the fleet as a means of reducing maintenance costs, but also increasing utilisation. For example, AF reduced multi-stops, and variations in aircraft types. In September 1995, AF flew the same number of hours in medium-haul as in September 1994, but with four fewer aircraft. On long-haul routes, AF flew 7% more hours with two fewer aircraft.[43] The aim was to increase overall aircraft utilisation by 10%.

Third, more than 10 destinations were cut from medium to long-haul, including Paris to Glasgow, Bari, Lima, and Windhoek. Instead, AF increased frequencies on the lucrative transatlantic destinations to San Francisco, New York, and Los Angeles.[44] European frequencies were increased to Stockholm, Rome, and Frankfurt, the last of which was a direct attempt to compete with Lufthansa.

Last, AF focused on developing their Charles de Gaulle hub for international travel, while Orly was primarily maintained for domestic and European medium-haul routes. This is similar to BA with Heathrow and Gatwick, for the purpose of a better division of management and establishing flight connections.[45]

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[39] Christian Blanc, internal message from AF President to employees, 28 July 1994, Archives Nationales AN 20180301/133.
[40] La Crevette Rouge, Communist newspaper, *Who pilots Air France?*, 3 August 1994, Archives Nationales AN 20180301/111.
[41] French National Assembly Finance Commission, Question No. 20, 1 September 1994, Parliament Finance Commission files (1992-94), Archives Nationales AN 20180301/127; L'Express newspaper, 7 April 1994.
[42] French Senate, First Ordinary Session of 1994-95, No. 81, annex to the minutes of the meeting on 22 November 1994, Archives Nationales AN 20180301/128.
[43] Air France, *Presentation of 1995-96 Programme*, 19 June 1995, Archives Nationales AN 20180301/36.
[44] AF, *1995-96 Programme*; Le Figaro newspaper, 11 January 1995, Archives Nationales AN 20180301/36.
[45] AF, *1995-96 Programme*.

Knowing that a strong AF could only be achieved through partnerships, Blanc and AF also rushed to ally and begin code-sharing with strong American partners like Delta and Continental in 1996. This materialised through harmonisation of frequent flyer programmes and increasing the linkages between the Charles de Gaulle hub with North American destinations like Houston and Atlanta. For AF, this was a priority given that its main competitors BA and Lufthansa had already made important strides in their code-sharing agreements, especially with the other two airlines from the U.S. Big Three. The main AF code-sharing agreements of this period are summarised in Table 5.4.

Table 5.4 AF code-sharing agreements, 1992-96.[46]

Date	Airlines	Region	Code-sharing purpose
1992	Sabena	Europe	Consolidate West European market share/Acquired 37.5% minority stake in Sabena
1992	CSA Czech Airlines	Europe	Develop Central and East European routes/Acquired 19% minority stake in CSA
1993	Air Canada	North America	Develop transatlantic routes and partnership/Increase flight frequency on the Paris-Toronto route
1995	Aeromexico	South America	Develop South American network and link to transatlantic U.S. routes
1996	Delta	North America	Develop transatlantic network/Increase flight frequency on Paris-Atlanta route/Link frequent flyer programmes
1996	Continental	North America	Develop transatlantic network/ Increase flight frequency on Paris-Houston route/Link frequent flyer programmes

Beyond the transatlantic and European agreements, the above code-sharing also highlights a scale strategy similar to BA and Lufthansa via the establishment of a worldwide network. As noted in the following main section, this was the precursor to the SkyTeam alliance formation. However, there is a noticeable lack of partners in the Asia/Oceania region, an aspect which was only addressed later with the 1998 Korean Air code-sharing for the Paris-Seoul route.[47]

[46] Bankers Trust, Groupe Air France internal report, 1 January 1997, Councillors of the Prime Minister files (1995-2001), Archives Nationales AN 20040261/9; New York Times, *Aeromexico Accord*, 29 November 1995; La Tribune newspaper, 7 December 1993, Archives Nationales AN 20180301/44.
[47] The Korea Herald, *Air France celebrates 30 years in Korea*, 4 July 2013.

5.2.2 AF recovery and the socialist Jospin government, 1997-99

AF gradually recovered after 1994 due to the Blanc rationalisation programme. By 1996-97, AF registered its first net profit of the 1990s decade (Table 5.5).

Table 5.5 AF recovery, 1993-97.[48]

Year	Net Profit (in billion francs)
1993	-8.5
1994	-2.3
1995	-0.9
1996	0.4
1997	0.2

With a recovery achieved, AF could now prepare for majority privatisation. At least, that's what Blanc hoped for.[49] Those plans, however, were thwarted by the 1997 arrival of the socialist government led by Lionel Jospin.

Jospin described himself as a "leftist realist", a pragmatist socialist who embraced deregulation and privatisation, although to a limited extent.[50] In this sense, Jospin only agreed to a partial and minority sale of AF ownership with an aim to achieve a sale sometime during 1998-99. The French government maintained its majority stake on grounds of political sensibility. This positioning, however, displeased both the left, which accused Jospin of breaking his previously-promised socialist party principles of halting privatisation and the right, which demanded a full privatisation of AF.[51]

International media was posing the question "To be, or not to be, capitalist?" to highlight this government ambivalence.[52] After failed behind-the-scenes negotiations with Jospin, Blanc also resigned from AF on account of government indecision related to the privatisation.[53] Blanc left AF with a warning: "In the ferociously competitive world of air transport today, the clock is ticking".[54]

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[48] Christian Blanc, letter to Alain Madelin, 1995 French Economy and Finance Minister, 26 June 1995, Archives Nationales AN 20180301/112; Bankers Trust, Groupe Air France internal report, Archives Nationales AN 20040261/9; New York Times, *Air France Posts First Full-Year Operating Profit Since 1989*, 27 June 1996.
[49] New York Times, *Government to Keep Control of Air France*, 5 September 1997.
[50] Financial Times, *Jospin shows off his 'leftist realism'*, 9 September 1997.
[51] Financial Times, 9 September 1997.
[52] New York Times, 6 September 1997.
[53] Air France, note to Jean-Pierre Jouyet, Jospin's Deputy Principal Private Secretary, 2 September 1997, Administrative Council files, Archives Nationales AN 20040261/9.
[54] Blanc, in New York Times, 6 September 1997.

Indeed, AF was trailing behind other major European airlines in terms of privatisation planning. Lufthansa was just completing its full privatisation the same year, the Dutch government further decreased its shareholding in KLM to a 14% minority ownership in 1998, while the Spanish government had announced plans for a full privatisation of Iberia by 1999. At the same time, the EU was more critical of state aid for flag carriers, especially in reference to the previous aid AF had already received with authorisation from Brussels.[55] By 1997, the majority of the European airline market had been liberalised in terms of market entry, fares, and routes, making this EU stance all the more evident.

Blanc's successor was Jean-Cyril Spinetta (Picture 5.8).

Picture 5.8 Jean-Cyril Spinetta, AF chairman, 1997-2003.[56]

Voted in on 23 September 1997 by the AF Board of Directors, Spinetta continued Blanc's strategy of developing a scale strategy through partnerships and importantly, a global alliance. The study addresses this in the following section. At AF, Spinetta aimed at reducing staff costs by offering pilots shares for wage cuts in 1998.[57] AF further enjoyed the improvements to its Paris Charles de Gaulle hub with the expansion of two runways in 1998 and 2000, with the goal of increasing aircraft movement and traffic at the hub.[58] Spinetta also oversaw the 1999 and 2004 privatisations and KLM merger as the first chairman of the AF-KLM group.

[55] World Airline News, *EU's Future Transport Commissioner Promises Tough Line On State Aid*, 16 January 1995, Archives Nationales AN 20180301/36.
[56] Copyright belongs to Laurent Villeret, featured in Financial Times, 1 April 2013.
[57] Financial Times, 14 October 1998.
[58] Aéroports de Paris, *Document de Référence 2006*, No. 07-047, 27 April 2007.

5.2.3 Partial privatisation, 1999

After behind-the-scenes discussions within the government throughout the end of 1997 and beginning of 1998, a 23 February 1998 press announcement revealed the opening of capital for AF for the end of the year.[59] However, staff wage negotiations postponed this plan until 8 December 1998, when an official decree was signed signalling the opening of capital by the end of the first quarter of 1999.[60] Nonetheless, the document mentioned that the government would maintain the majority ownership.

On 22 February 1999 the government reduced its stake in AF to a 54% majority through an IPO flotation. The main outcomes of this privatisation are summarised in Table 5.6.

Table 5.6 AF partial privatisation outcomes, 1999.[61]

Results	Data
Initial Share Price	14 Euros
Closing Share Price	16.4 Euros
Employee Participation	72% (10% of AF stake)
Shares Offered	6.9 million shares
New Individual Shareholders	2.4 million individuals
Market Valuation	3.1 billion Euros

Spinetta regarded the flotation as an "immense popular success".[62] The 1999 partial sale attracted over 2.4 million new individual shareholders. The closing day share price for individuals was situated at 16.4 Euros, 17% more than the 14 Euros starting share price. This highlighted pronounced interested in the flag carrier, especially in the context of AF recovery. As noted in Figure 5.2, the AF and KLM share price has consistently been attractive during and after privatisation.

[59] Dominique Strauss-Kahn, 1997-99 French Minister for Economics, Finances, and Industry, press announcement related to the opening of capital in AF, 23 February 1998, Archives Nationales AN 20040261/9, Declassification approved on author's request.
[60] Roland Peylet, Prime Minister councilor, notes for the Prime Minister related to the AF capital opening, 8 December 1998, Archives Nationales AN 20040261/9, Declassification approved on author's request.
[61] French Ministry for Economics, Finances, and Industry, press announcements, 20 February and 29 March 1999, Archives Nationales AN 20040261/9, Declassification approved on author's request; Libération newspaper, 23 February 1999; BBC News, *Air France shares take off*, 22 February 1999.
[62] Libération, 23 February 1999.

Figure 5.2 AF-KLM share price evolution, 1999-2005.[63]

AF outmatched the 1.1 million initial individual shareholders of the BA sale, but also Lufthansa's 400,000 new individual shareholders for its final 1997 privatisation round. 72% of AF employees took up shares in the company. This was not as much as the BA figure of 94% of employees, although the overall stake employees eventually held in each airline came close to 10%. Therefore, AF civil servants also became employees and shareholders within their company. In this sense, the study acknowledges how major airlines like AF, BA, and Lufthansa have successfully contributed to the formation of employee shareholders through the process of privatisation. This status change from civil servants to employees and shareholders has remained a common feature of IPO sales at other airline privatisations, including Iberia, KLM, and Turkish Airlines, among others.

5.2.4 The involvement of consultancies in the AF privatisation

The AF sale was also guided by international consultancies, which largely explain the commonality of the IPO model and flotation characteristics like discounted employee shares, advertising, and international listings. Banks and consultancies like Morgan Stanley, which oversaw share distribution in overseas markets, alongside Lazard and Société Générale, who were in in charge of domestic and European sale structuring are present here. These consultancies have acted as advisors in other major airline privatisations, including those of

[63] Air France-KLM, 2005-06 Reference Document, p. 40. AF-KLM stock prices based on listings on the Euronext Paris and Euronext Amsterdam stock exchanges. "SBF 120" (Société des Bourses Françaises) denotes the French stock market index of the 120 most traded stocks listed on the Paris exchange. This includes companies like Airbus and Renault, among others. "Air Transport Index" comprises indices from the UK FTSE (Financial Times Stock Exchange) Transport and FTSE Airlines and Airports listings, including airlines like BA, easyJet, Iberia, and others.

BA, Lufthansa, and the Greek flag carrier Olympic Airlines.[64] As a result, the transnational element of privatisation and its international consultancies are distinguished here as well.

However, the mystery surrounding the detailed involvement of these consultancies within the privatisation planning is also present, same as with the BA and Lufthansa cases. The extent of their involvement in the AF privatisation is even more challenging to research given the more recent AF privatisation compared to BA and Lufthansa and the present extensive classification of the archival material. Future declassification of material may hopefully reveal a more detailed role of these consultancies in the AF privatisation process.

With the successful partial sale behind it, AF could now only look forward to a new government for further privatisation to occur. That would take several years. Despite Balladur's earliest endorsement of full privatisation as his ideal ownership arrangement, AF would still not be fully private. This is discussed in the following section.

5.3 SkyTeam, KLM merger and second privatisation, and beyond, 2000-22

In this final part of the chapter, the AF establishment of the SkyTeam alliance is addressed. Unlike BA and Lufthansa, AF achieved this before a further privatisation and during majority state ownership. In this sense, AF could not wait for further steps toward a full privatisation before further developing its scale strategy and alliance formation. The merger with KLM was also the first important example of an airline merger within the European setting, determining the subsequent IAG and Lufthansa Group mergers. Yet this merger also served as a further privatisation for AF as the government's stake was diluted to a minority ownership. The section concludes with the French government response to the COVID-19 pandemic, highlighting that the government has continued maintaining a strategic stake in AF, despite previous rhetoric of full privatisation as an aim.

5.3.1 SkyTeam, 2000-22

In the same manner as BA and Lufthansa, AF was also instrumental in the formation of the most recent of the major airline alliances, SkyTeam. SkyTeam was officially announced on the 22 June 2000 as a response to Star Alliance and Oneworld. The original members included AF, Delta, Korean, and Aeromexico.

The deeper integration and the formation of the alliance resulted from the code-sharing agreements previously established. The SkyTeam alliance partners developed and

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[64] Financial Times, *Lazard to advise Greece on finances*, 5 May 2010; FlightGlobal, *French Government gets going on Air France privatisation*, 11 February 1998, Retrieved from: https://www.flightglobal.com/french-government-gets-going-on-air-france privatisation/19465.article [Accessed on 16 January 2023].

harmonised their frequent flyer programmes, offering additional benefits such as more convenient check-in and ticket purchasing opportunities. As example, frequent flyers accumulated and redeemed miles by traveling with any of the alliance members. Furthermore, passengers connecting from one member flight to another only had to check-in once to save travel time.[65] As previously explained, these steps have also been common among Star Alliance and Oneworld.

As with the previous two alliances, a U.S. mega-carrier (in this case Delta) was desired to be included in SkyTeam as a means of developing profitable transatlantic linkages. This is most evident with the inclusion of Continental and Northwest during the 2004 first major expansion of the alliance. Consolidating the European market was also a priority for AF and SkyTeam. This was reflected in the addition of KLM, Alitalia, and CSA Czech Airlines as members to the alliance starting 2001. The original members and the additions are presented in Table 5.7.

Table 5.7 SkyTeam alliance members, 2000-06.

Date Joined	Airlines	Region	Ownership (at joining)
2000	Air France	Europe	54% public
2000	Delta	North America	100% private
2000	Korean	Oceania/Asia	100% private
2000	Aeromexico	South America	60% public
2001	CSA Czech	Europe	90% public
2001	Alitalia	Europe	60% public
2004	KLM	Europe	56% private
2004	Continental	North America	100% private
2004	Northwest	North America	100% private
2006	Aeroflot	Europe	51% public

The formation of SkyTeam follows the same industry dynamic as present with Star Alliance and Oneworld. Specifically, pronounced competition from other airlines, and in this case alliances, led to increased cooperation between AF and partners. This cooperation intensified under the form of code-sharing, leading to the formation of the third alliance.

[65] Delta News Hub, *Q&A: SkyTeam benefits customers*, 20 July 2015, Retrieved from: https://news.delta.com/qa-skyteam-benefits-customers [Accessed on 16 January 2023].

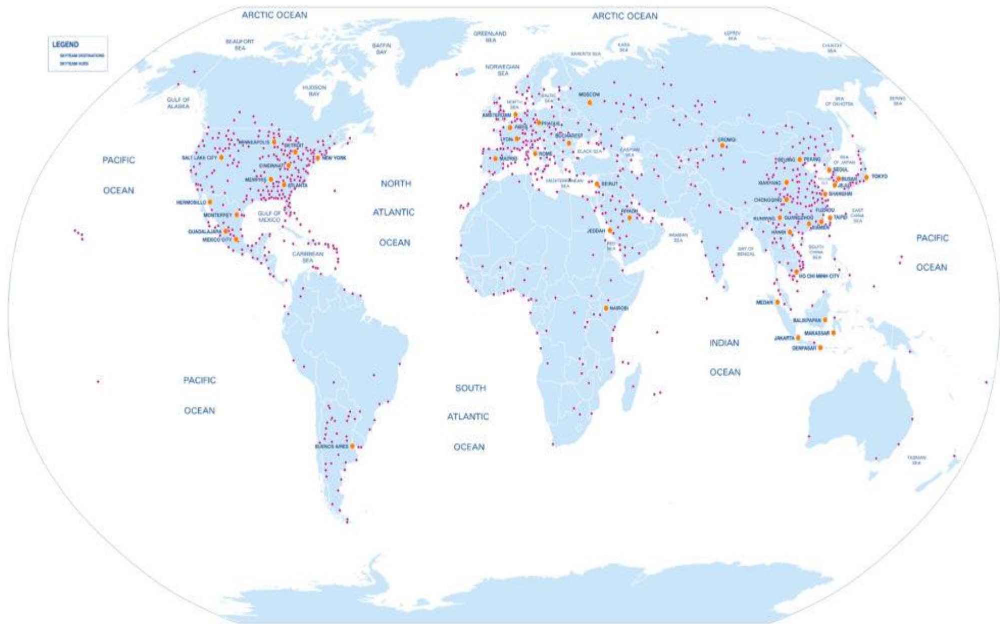
Consequently, the SkyTeam alliance (and later the KLM merger) led to the further consolidation of the market. AF, in the same manner as BA and Lufthansa, fits within the "3C's" configuration of industry characteristics due to its pursuit of the scale strategy by means of cooperation through code-sharing agreements and consolidation via alliance formation and the merger with KLM.

SkyTeam, despite being the latecomer alliance, was quick to increase its market share, especially compared to Oneworld. SkyTeam had a 10% market share of total passenger revenue at formation compared to Oneworld's 16.2% market share. Yet, SkyTeam overtook Oneworld by 2004, 19% vs. 15% due to the inspired SkyTeam membership enlargement. This was highlighted in Table 3.10 from Chapter 3. The SkyTeam success has also happened despite analyst criticism that the alliance was essentially a group of "leftover" airlines due to their various issues—AF recovering from near bankruptcy, Aeromexico having labour and ownership disputes, Korean Air struggling to develop its Seoul hub, etc.[66]

While this standing has maintained until recently, it is important to note that the COVID-19 pandemic has determined several changes. This has to do with how quickly the alliance network recovers from pandemic levels low traffic. For example, Oneworld has recovered quicker than SkyTeam in summer 2022 traffic due to a stronger presence in transatlantic flights.[67] Nonetheless, SkyTeam continues to lead over Oneworld, although the difference between them in terms of market capacity has diminished, 13.7% vs. 11.9%.[68] Star Alliance continues to lead at 17.4% market share for 2022. How airlines and alliances recover from the pandemic will be a noteworthy focus of discussion for future research as traffic rebounds. Picture 5.9 highlights the most recent SkyTeam membership and network as of 2021-22.

[66] CNN Financial News, *Four airlines in alliance*, 22 June 2000.
[67] Simple Flying news, *25 Years On: Inside the Three Global Airline Alliances*, 3 March 2022.
[68] Official Aviation Guide (OAG) Market Analysis, *Airline Alliances…Time To Change Partners?*, 7 December 2022.

Picture 5.9 SkyTeam members (above) and network with hubs highlighted (below), 2021-22.[69]



SkyTeam has expanded over time to include more Asian flag carriers like China Airlines and Vietnam Airlines, a market in which it lacked substantial presence before. As a result, new hubs were developed in Shanghai, Beijing, and Ho Chi Minh City. In Europe, SkyTeam expanded to include TAROM, the Romanian flag carrier, along with the Spanish Air Europa, and Aeroflot, the Russian carrier. However, due to the 24 February 2022 Russian invasion of Ukraine, Aeroflot has been indefinitely suspended from the alliance starting 28

[69] Copyright belongs to Milesopedia, *Virgin Atlantic joins the SkyTeam alliance*, 27 September 2022; Retrieved from: https://milesopedia.com/en/news/virgin-atlantic-rejoint-alliance-skyteam [Accessed on 16 January 2023]; AwardWallet, *Beginner's Guide to Airline Alliances and Partnerships*, 27 October 2022, Retrieved from: https://awardwallet.com/blog/airline-alliances-and-partnerships [Accessed on 16 January 2023]. Please note that Aeroflot has been suspended from the alliance on the 28th April 2022 due to the 24th February 2022 Russian invasion of Ukraine.

April 2022. Despite this, SkyTeam is stated to expand further in the future. In 2023, Virgin Atlantic, the privately-owned British airline, will join SkyTeam. This addition will strengthen SkyTeam's presence at the Heathrow and Manchester hubs, but also expand daily flights to New York, Los Angeles, Miami, and San Francisco.[70] As ever, the transatlantic routes carry strategic importance for all the major alliances.

5.3.2 AF-KLM merger and second privatisation, 2002-04

After the success of the SkyTeam formation, AF encountered more favourable conditions for a further reduction in state ownership. Nonetheless, AF would still not experience a full divesture from the French state.

First, the new 2002 government led by the centre-right premiership of Jean-Pierre Raffarin advocated for increased decentralisation and deregulation in the economy through another privatisation programme. Unlike Jospin, the Raffarin government advertised AF as a candidate for further privatisation almost immediately in July 2002. The government and AF management agreed over the next step for the airline, arguing that "privatisation constitutes a normal evolution and a logical continuation of the opening of capital carried out in 1999".[71] The government's plan included a 20% further reduction in its AF stake. However, the details of a second privatisation were not yet advertised. The French government was still cautions against a full privatisation, citing strategic reasons for maintaining its presence.

Second, the recovery and leadership of Spinetta in continuing cost-cutting efforts in the late 1990s resulted in a favourable situation at AF. As a result, AF survived and rebounded better from the 2001 crisis than any of its European competitors. Furthermore, this finally gave AF the image it always sought throughout the 1990s—that of a healthy and performing flag carrier. This aspect was especially important in KLM's decision to partner with AF. The post-2001 AF profitability is summarised in Table 5.8.

[70] SkyTeam press announcement, *Virgin Atlantic to join SkyTeam Alliance*, 27 September 2022.
[71] Le Monde, 31 July 2002.

Table 5.8 AF profitability, 2001-08.[72]

Year	Net Profit (in million Euros)
2001	421
2002	153
2003	195
2004*	351
2005	913
2006	944
2007	870
2008	791

Despite the very good consolidated profit of the AF-KLM merger post-2004, the early 2000 situation at KLM was not as good as that at AF. KLM posted a net loss of 156 million Euros for 2001.[73] This coupled with its small domestic market, meant that KLM's future involved developing closer partnerships. In 2002-03, KLM was negotiating merger opportunities with Alitalia and AF. KLM leadership admitted the following when pursuing this strategy:

> Around the start of the new millennium, we concluded at KLM that partnering with one of the top three European network carriers (British Airways, Lufthansa or Air France) was inevitable. This was the result of the vision that globally there would be, over time, only room for three major alliances, each centred in Europe around one of the top three. This was a crucial strategic insight…[74]

By late 2003, AF and KLM were already in advanced talks of a merger. Alitalia was ruled out by KLM due to its ongoing profitability issues. However, KLM found a strong partner in AF, but also a way to comprehensively link its Amsterdam Schiphol hub to Paris Charles de Gaulle. In this sense, the merger ensured the establishment of the largest network by any European airline or group.

[72] Air France-KLM Group, *Consolidated Financial Statements*, ending 31 March 2008 and 18 May 2006; New York Times, *Air France-KLM's profit triples*, 24 November 2005.
* Please note that the net profit starting the year 2004 includes KLM due to the AF-KLM merger. This also explains the jump in terms of profits after 2004.
[73] CNN Europe, *KLM posts full-year loss*, 8 May 2002.
[74] Sveinn Vidar Gudmundsson, *Mergers vs. Alliances: The Air France-KLM Story* (Toulouse Business School, University of Toulouse, Ref. C02/10/2014, 2014, Unpublished), p. 8.

On 30 September 2003, the merger was officially announced. Table 5.9 summarises the outcomes of the merger.

Table 5.9 AF-KLM merger outcomes, 2004.[75]

Outcomes	Data
AF buyout sum of KLM	784 million Euros
French government stake	44% of AF-KLM
AF shareholders stake	37% of AF-KLM
KLM shareholders stake	19% of AF-KLM
Destinations served	226 cities
Combined fleet	540 aircraft
Combined number of employees	106,000

Here too the EU, and the French and Dutch governments allowed this merger despite international concerns about distorting competition. In return, the EU requested that AF-KLM renounce 94 daily take-off and landing slots from Paris and Amsterdam to minimise the disruption of competition.[76] The representatives of AF-KLM argued that allowing the merger to proceed was the correct decision as "the airline industry is fragmented and its current competitive structure, with national carriers for each individual country, is an inheritance from a former era. This has contributed to low profitability and lack of value creation for shareholders".[77] The AF-KLM representatives were correct in their assessment of the dominance of the national flag carrier. Nonetheless, their statement also predicted the move for further consolidation within the European airline industry, which is highlighted below.

The AF-KLM merger was officially completed on 3 May 2004, with stocks in the new merger being made available on the Euronext Paris and Amsterdam as well as the New York Stock Exchange starting 5 May 2004. Due to the merger, AF essentially experienced a *de facto* second privatisation. As AF acquired KLM, the French government stake was diluted to 44% of AF-KLM ownership. The AF private shareholders received 37% of AF-KLM, while the KLM private shareholders were allocated 19% of the merger's ownership. Nonetheless, the deal was structured as to allow Dutch interests to retain strategic control of

[75] Deutsche Welle, *Air France and KLM to Form Huge New Alliance*, 30 September 2003; CNN Business, *Air France to buy rival KLM*, 30 September 2003.
[76] European Commission press release, *Commission clears merger between Air France and KLM subject to conditions*, 11 February 2004.
[77] CNN Business, *Air France to buy rival KLM*.

the KLM operations. In this sense, AF and KLM continued to operate separately under their own identities. Nonetheless, the merger meant that it came with several cost advantages, including for example the pooling of resources related to shared passenger lounges as well as support services like catering. Importantly, the merger signalled that competition within the European space was changing to also include mergers, not just alliances. Table 5.8 above highlights the jump in net profit after 2004, confirming that the AF-KLM merger was indeed a lucrative arrangement (Picture 5.10).

Picture 5.10 AF Chairman Jean-Cyril Spinetta (left) and KLM Chairman Leo van Wijk (right) celebrating the merger together with airline representatives, 2004.[78]

As this study has previously highlighted in chapters 3 and 4, the AF-KLM merger also led the way for the subsequent creation of the IAG and Lufthansa Group mergers as a response to increased competition posed by the merger. This led to a need of intense cooperation among the other European airlines to match this competition. As the IAG and Lufthansa Group mergers occurred, the European industry consolidated further. Consequently, the AF-KLM merger also fits within the “3C’s” industry dynamics.

The AF-KLM example of privatisation through an acquisition of a strategic partner is reminiscent of the previously mentioned passive privatisation found with the Lufthansa case. While it is different from Lufthansa in the sense that AF acquired KLM, it is also a form of passive privatisation because of the share dilution. Over time, however, the French government share in AF-KLM has decreased due to subsequent rounds of capital raising. In

[78] Copyright belongs to KLM (2004), picture featured in Luchtvaart Nieuws (Aviation News) Netherlands, April 2019.

2019, the French government stake was diluted to a 14% ownership of AF-KLM. At the same time, the Dutch government increased its stake from 6% to close to 14% strategic ownership of AF-KLM without announcing the move beforehand. This was intended to match the influence of the French government and to ensure that the Dutch government also had a "seat at the table".[79]

The move attracted criticism from the French side, accusing the Dutch government of acting like an "unfriendly corporate raider".[80] Yet these subtle moves over the strategic control of AF-KLM were not the only controversial events that happened. For example, there have been several disagreements over the autonomy of KLM in this merger through the appointment of Canadian CEO Benjamin Smith in 2018. Smith was contested by the KLM side as favouring French interests by exerting more authority on KLM operations.[81] In 2017, a leaked internal report highlighted cultural differences between AF and KLM staff. The report concluded:

> The French have the impression that the Dutch think only of money and are always ready to fight for profit. They are not afraid of anything.
>
> The Dutch think that the French are attached to a hierarchy and political interests which are not necessarily the same as the interests of the company…[82]

Differences between companies have occurred before, especially as a result of international mergers. A famous example comes from the automotive industry. In 1998, there was a culture clash between Daimler-Benz and Chrysler, where both companies exercised different organisational structures and autonomy.[83] Ultimately, the troubled and infamous Daimler-Benz and Chrysler merger dissolved in 2007 after years of losses and redundancies.[84] In contrast, the AF-KLM merger continues to operate successfully despite these culture clashes. It is difficult to find an explanation as to why the AF-KLM merger has succeeded compared to the Daimler-Benz and Chrysler merger given the different industries, management, and ownership structures. Nonetheless, a possible explanation can be attempted. The industry specificity of the airline sector and its network type characteristics means that integration and harmonisation of the hub-and-spoke model is essential between

[79] BBC, *Air-France KLM: Dutch surprise France by taking airline stake*, 27 February 2019.
[80] The UK Guardian, *France fumes as Dutch government takes stake in Air France-KLM*, 27 February 2019.
[81] BBC, *Air-France KLM: Dutch surprise France by taking airline stake*, 27 February 2019.
[82] The UK Guardian, *French-Dutch culture clash revealed in leaked Air France-KLM report*, 20 July 2017.
[83] Financial Times, *Mergers, like marriages, fail without a meeting of minds*, 15 May 2007.
[84] The UK Guardian, *From $35bn to $7.4bn in nine years*, 14 May 2007.

the companies. In comparison, the automotive industry does not feature the same network characteristics, meaning that greater integration of operations may not be pursued to the same extent.

In the AF-KLM case, a special situation is noted, where two governments have regarded the two flag carriers with utmost strategic importance. This scenario exemplifies that there have been limits on how much to privatise without encountering the loss of a strategic stake. Unlike BA and Lufthansa and despite privatisation efforts, AF-KLM is unlikely to become fully private in the near future. In fact, the pandemic context has contributed to an increased French government shareholding through the bailout of the company.

5.3.3 State involvement continues

Like BA, Lufthansa, and the entire industry, AF-KLM was also affected by the COVID-19 pandemic effects. Similar to Lufthansa, the French government intervened with a large bailout in exchange for ownership, amounting to 4 billion Euros, while the Dutch state contributed with 2 billion Euros.[85] In the process, the French government stake in AF-KLM nearly doubled to nearly 30% ownership, while the Dutch stake diluted to 9.3% ownership.[86] This made the French government the single largest shareholder in the company, effectively backtracking on the 2004 stake reduction.

This bailout has also reignited tensions with its Dutch partners. KLM and the Dutch government have accused the French government of attempting to nationalise the company and gain control.[87] To address these concerns, the French government has committed to withdraw its new stake in AF-KLM by 2025 as the company repays these loans.[88] This is similar to the steps made by the German government with Lufthansa.

However, this has yet to happen in the same manner compared to the German case. Lufthansa made its repayments already and the German state reverted its stake involvement, whereas AF-KLM made two repayment tranches totalling 1 billion Euros, with more planned for 2023, 2024, and 2025. The ownership breakdown of AF-KLM as of 30 June 2022 is featured in Figure 5.3.

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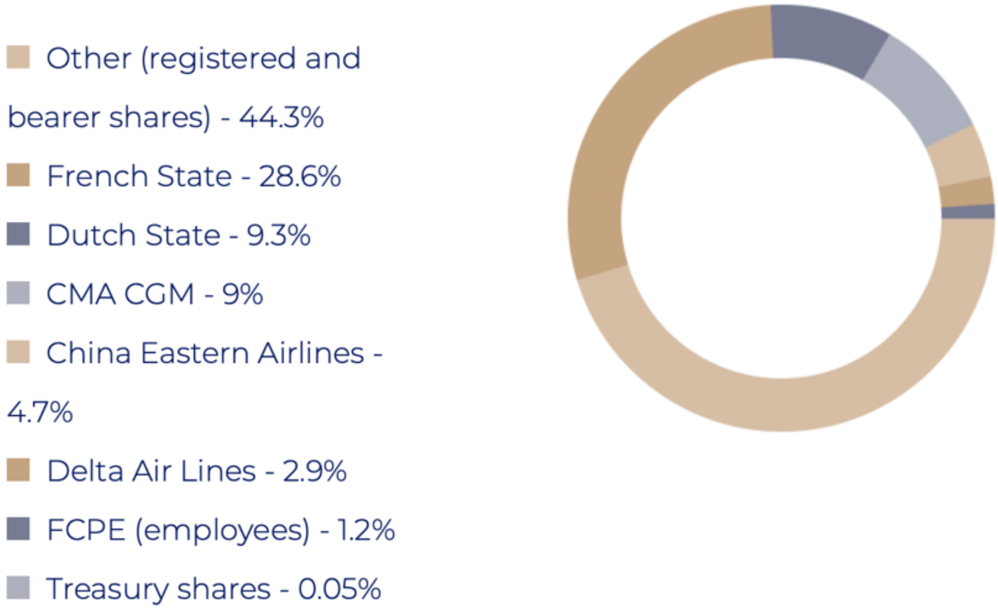
[85] Reuters, *Capital hike brings Air France under government's wing*, 6 April 2021.
[86] Reuters, *Capital hike brings Air France under government's wing*.
[87] Reuters, *Air France-KLM union tensions surface in bailout's wake*, 5 May 2020.
[88] AF-KLM Press Office announcement, 7 November 2022.

Figure 5.3 AF-KLM ownership breakdown, as of June 2022.[89]



Overall, the French government has maintained a direct involvement in AF over time, unlike the more indirect relationship now present at BA and Lufthansa. Yet despite these different ownership structures, flag carriers like AF, BA, and Lufthansa have been advantaged by their relationship with national governments as they have been deemed "too big to fail". This represents an industry characteristic made evident by recent events, which the media has been quick to criticise.[90] Time and government reactions will tell if the COVID-19 bailout and state intervention is temporary and will be reverted, or whether the pandemic has exposed the underlying reliance of the flag carrier on its national government during cyclical events.

5.4 Conclusions

This chapter has examined the AF privatisation processes. The chapter has also considered the industry dynamics related to the privatisation and since. The following have been discussed:

- In terms of the dynamics behind the firm, AF also saw BA as an example for its rationalisation programme in preparation for recovery and privatisation. As a result, AF embarked upon a rationalisation programme under the Blanc

[89] Courtesy of AF-KLM, *Shareholding structure*, 30 June 2022. Please note this does not feature the most recent stake developments because of ongoing bailout repayments.
[90] France 24 news, *Too big to fail, or too broke to fly? Airlines seek government support to stay in air*, 27 April 2020.

leadership, similar to the one also followed by Lufthansa by cutting expenditure, routes, and focusing on transatlantic operations. A strategy of scale was also the priority at AF. Unlike Lufthansa, however, AF chose to acquire its immediate domestic competitors, similar to BA. Thereafter, AF followed the path of cooperation through code-sharing, alliance formation, and mergers.

- In terms of industry wide dynamics, AF established the SkyTeam alliance and the first airline merger in the European setting as a result of the 2004 AF-KLM merger. Consequently, AF also contributed to the consolidation of the industry, exemplifying the "3C's" industry dynamic. A convergence of similar strategies is observed between BA, Lufthansa, and AF despite ownership and privatisation differences.

- Political ambivalence was important in ultimately deciding the course of the AF privatisation. The 1999 partial AF privatisation exemplifies this. The socialist Jospin government did not pursue full privatisation despite previous rhetoric from Balladur. Nonetheless, subsequent governments have continued to hold a strategic interest in AF. This is best exemplified by the 2004 KLM merger and tensions surrounding the French government's stake in the new group.

- The French government has maintained the most direct presence in AF among BA and Lufthansa. Similar to Lufthansa, however, the French government also directly intervened with the 1990s bailout as a means of helping AF recover and pursue privatisation. Nonetheless, the French state has continued to directly influence AF by keeping a sizable strategic interest, going beyond the more indirect and custodian-like role experienced by BA and Lufthansa with their governments. The 2004 KLM merger and the COVID-19 bailout have exposed this type of relationship at AF. Like BA and Lufthansa, the AF situation also exemplifies the "too big to fail" scenario.

- Consultancies, including Morgan Stanley and Lazard, have helped AF structure the 1999 flotation. Common elements and consultancies can be observed between BA, Lufthansa, and AF in terms of sale preparations and support, ranging from the adoption of the IPO model as a standard to the discounted shares offered to employees. In this sense, international consultancies hold a direct involvement within the airline privatisation and sales structuring process. Nonetheless, their detailed role in the AF privatisation process continues to be extensively classified at present.

The following chapter provides a conclusion to the study by discussing several main remarks.

Chapter 6. Concluding Remarks

The focus of this study has been to trace the processes behind the privatisation experiences of the three largest flag carriers within the European setting, BA, Lufthansa, and AF. By doing so, this study has highlighted the particularities of the European airline privatisation experience, the dynamics related to the firm and industry as a result of deregulation, and how these privatisation and operational strategy elements connect and diverge between the flag carriers and the industry at large. Developments have been discussed by considering temporality and developments throughout time. The main questions and the corresponding summarised answers are:

- What were the main processes behind the European airline privatisation experience? How did these develop over time?

BA, Lufthansa, and AF undertook similar privatisation processes of restructuring, rationalisation, flotation planning, change in employee status, as well as the use of international consultancies. This has been informed by the early example of the BA privatisation process. Over time, the BA privatisation served as a template for future airline privatisations given its successful flotation outcome. This is exemplified by the cases of Lufthansa and AF, both of which pursued privatisation after BA. Therefore, the BA rationalisation and flotation planning became an industry standard.

- How have these processes informed the developments in industry dynamics both at the flag carrier and industry-wide levels?

Privatisation, alongside deregulation in the industry, instilled greater discipline at the flag carriers, making them pursue rationalisation and the scale strategy to survive increased competition. The scale strategy meant establishing cooperation with other carriers in the form of investment, take overs, and code-sharing. Increased cooperation led to the formation of airline alliances and mergers, including the 2004 AF-KLM merger, as a means of consolidating market power and establishing a worldwide network. This resulted in the "3 C's" framework of Competition-Cooperation-Consolidation created in this study to best represent industry-wide developments.

- How has the relationship between flag carrier and government developed as part of the privatisation process?

The role of the government changed from direct involvement in the operations and acquisition policy of the flag carrier before the 1980s to a custodian-type and more indirect role because of privatisation. Nonetheless, the government-flag carrier relationship continues to be present even after privatisation by favouring the flag carrier in its operations. This flag carrier favouritism is best exemplified by the recent COVID-19 bailouts. However, this study has shown that governments also intervened to permit alliances and mergers to form, therefore facilitating the "3C's" framework.

For the purpose of the study and by means of utilising research categories, these questions are addressed in more detail below with reference to the industry dynamics, state-owned enterprises, and privatisation processes perspectives introduced in Chapter 1.

6.1 Industry dynamics

This study has discussed dynamics both at the firm level and industry by examining the processes behind privatisation and deregulation.

6.1.1 Intra-firm changes and strategy

BA, Lufthansa, and AF underwent similar rationalisation programmes as precursor to a successful flotation. Indeed, the rationalisation process has since been employed by other major airlines, including KLM, regardless of privatisation, becoming a standard practice in the industry. Nonetheless, this study has showed that there has been a clear association and presence of rationalisation as precursor to operational recovery and facilitator of a successful flotation outcome.

In the BA, Lufthansa, and AF rationalisation cases, this planning included cutting expenditure, unprofitable routes, and focusing on the deregulated and highly demanded transatlantic services as a means for recovery. It is important to note that BA served as a pioneer of this type of rationalisation in the 1980s under the leadership of John King. BA, faced with early 1980s losses, reoriented its operations through quick and pronounced rationalisation. For example, fleet homogenisation has also been a popular measure as part of rationalisation. BA, Lufthansa, and AF reduced the operational age of their fleet to improve efficiency and reduce costs. As explained in chapters 3, 4, and 5, the rationalisation method has been adopted by Lufthansa, under the Jürgen Weber leadership, and AF during the Christian Blanc tenure.

Similarly, the scale strategy has been adopted among BA, Lufthansa, and AF. Again, BA served as the early example given its acquisition strategy of the domestic BCal competitor, investment strategy, and code-sharing agreements during the late 1980s and early 1990s. While there have been small differences (i.e. Lufthansa bypassing investments for code-sharing partnerships, only to later return to investments in airlines like Swiss and Brussels Airlines), the aim and result has been the same—to develop to a large enough scale as to compete effectively with the largest airlines. AF also followed into this scale strategy through the acquisition of its domestic partners UTA and Air Inter, followed by the same code-sharing agreements. This widely-adopted scale strategy ultimately shaped the future of the industry. Importantly, all of the discussed major flag carriers, including KLM, SAS, and Alitalia have embarked upon this scale strategy regardless of ownership and privatisation status. As seen from airline chairmen statements and similar planning, the scale strategy has been the logical progression pursued by the industry as a means to survive the increasingly deregulated markets of post-1990s Europe.

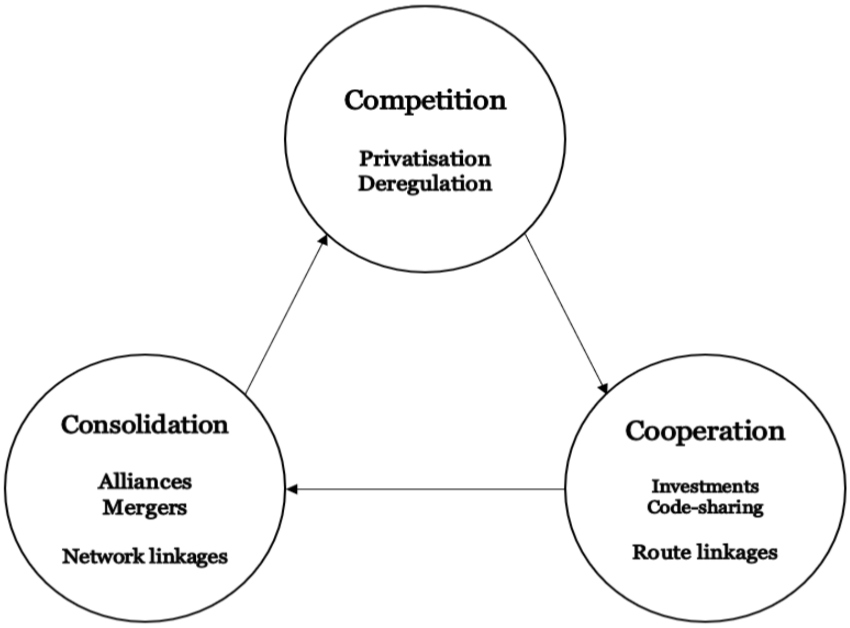
By highlighting these developments and emphasising the intra-firm dynamics, the study adds to the literature on firm changes in the context of the airline industry and privatisation. This study is positioned in such a way as to reflect upon the deregulation and privatisation developments as well as the similarities in terms of strategy happening within the top three European flag carriers.[1]

6.1.2 Industry dynamics and the "3C's" framework

The above developments in the firm have been informed by but also led to the development of a specific deregulated industry framework. The experiences of and the developments at the largest three European flag carriers, BA, Lufthansa, and AF have contributed to the formation of this framework within the European setting. This self-developed "3C's" framework highlights the dynamics of changes outside the firm. This is reproduced below in Figure 6.1 as a reminder.

[1] Francesca Fauri, "The Italian State's Active Support for the Aeronautical Industry: The Case of the Caproni Group, 1910-1951", *Business History Review*, Vol. 95, No. 2, Summer 2021, pp. 219-247; Hans-Liudger Dienel and Peter Lyth (eds.), *Flying the Flag: European Commercial Air Transport since 1945* (Basingstoke: Palgrave, 1998).

Figure 6.1 "3C's" deregulated industry framework.[2]



This study explained the framework, which describes the current deregulated airline industry, in the following manner.

Competition: Privatisation and deregulation during the 1980s and 1990s have induced the threat of competition among a previously protected market which has historically advantaged flag carriers. Legacy carriers, including BA, Lufthansa, and AF perceived the increasingly deregulated markets and the self-disciplining of privatisation as an ultimatum for performing more efficiently to survive incoming entrants.

Cooperation: This competitive threat alongside with new entrants facilitated by liberalised bilateral and multilateral agreements have pushed flag carriers into the scale strategy. The scale strategy rested in seeking cooperation by means of investments in and take overs of other airlines, but also establishing partnerships through code-sharing agreements. The main aim here has been to establish route linkages. This has been a popular strategy throughout the 1990s.

For example, BA has pursued the scale strategy by means of acquiring BCal and pursuing code-sharing agreements with partners such as American and Canadian Airlines. Lufthansa, while bypassing the acquisition stage for the time being until the establishment of the Lufthansa Group, nonetheless pursued code-sharing agreements with airlines like United and SAS. AF acquired its domestic competitors UTA and Air Inter, while also pursuing code-sharing agreements with airlines like Delta and Air Canada.

[2] Reproduced from Figure 1.1 in Chapter 1. This figure represents the author's own interpretation of the deregulated industry configuration.

Consolidation: From these investments and code-sharing agreements, a consolidation of the industry has occurred starting in the late 1990s through the formation of the top 3 alliances explored in this study, Star Alliance (co-founded by Lufthansa in 1997), Oneworld (co-founded by BA in 1999), and SkyTeam (co-founded by AF in 2000). The post-2000 merger movement started by the 2004 AF-KLM merger, followed by BA and Iberia with IAG, and the Lufthansa Group further consolidated the industry. The main aim here has been the establishment of a network spanning the world, as well as the creation and harmonisation of frequent flyer programmes to deliver advantages to customers. This study shows that these major flag carriers have eventually converged in their aim and steps to facilitate consolidation.

New carriers join and leave these alliances under different circumstances (e.g. this study has highlighted that Aeroflot has been suspended from SkyTeam due to the 2022 Russian invasion of Ukraine). However, competition continues to exist, now specifically between these alliances. Their main aim is to attract other airlines into the alliance and expand their market share, although this has become increasingly difficult due to the presence of a high degree of industry consolidation where the world's major airlines are already involved in these alliances.

The "3C's" industry dynamics framework highlights that competition and cooperation go hand-in-hand to form the specificity of the airline industry and its network-type characteristics. These network characteristics so specific to the civil aviation industry have resulted from alliances and mergers meant to provide services which go beyond the operational capabilities of any standalone carrier. In this sense, no airline has been capable of achieving such a widespread network on its own as to rival the forces of cooperation and consolidation in the sector. This has been most evident throughout chapters 3, 4, 5, and in statements from BA, Lufthansa, AF, and KLM representatives. These leading figures realised throughout the 1980s and 1990s competition that the scale strategy and cooperation were the viable options for survival and consolidation. These network characteristics were helped to develop by governments and the EEC/EU by approving alliances and mergers, but also granting antitrust immunity with special conditions, such as renouncing airport slots. In this sense, international organisations and governments have also supported and contributed toward the network characteristics of this industry.

This framework adds to scholarship on industry dynamics, specificity, and strategy by going beyond the firm-centric approach present in the works by Alfred Chandler Jr., although also expanding upon Michael Porter's definition of industrial competition by providing the present example of international cooperation and pronounced alliance formation in the context of the airline industry.[3] The industry specificity of the airline industry has long been neglected in industry dynamics scholarship. Indeed, this study has employed works by Doganis, Holloway, Belobaba and Odoni, Barrett, and O'Connor especially in chapters 1 and 2. All of these studies have discussed industry specificity to a great extent.[4] Nonetheless, these works have not examined the intra-firm developments of major flag carriers and how these have shaped industry dynamics, nor have these explored airline privatisation to the extent present in this study.

By highlighting these changes at the firm and beyond the firm levels and connecting it with the dynamics within the industry, this study provides a similar perspective of inside and outside dynamics as found in the research by Stokes, Kurosawa, Owen, and Fear.[5] Nonetheless, this study takes this further by presenting this perspective within a more international scope by also discussing how cross-border alliances and mergers have been established.

Temporality plays an important part in explaining how the "3C's" framework has formed, as well as how processes have developed to facilitate airline privatisation. In this sense, the study also engages with temporality and developments over time to present how these flag carriers developed through the privatisation process and since. The timeframe focuses on the post-1980s period. As a result, this study captures the main developments within the industry and how the "3C's" framework has been formed due to structural changes informed by flag carriers, governments, and organisations. This study has shown how the industry was highly rigid and regulated pre-1980, leading to flag carrier syndrome situations. After deregulation and privatisation in the sector, flag carriers were exposed to competition, but also to cooperation, alliances, and mergers. Similarly, the role of the government developed from direct intervention to custodian-type indirect presence, although with exceptions in cases as that of AF, where state involvement continues to be direct via strategic stake holding. In this sense, temporality is important in portraying industry specificity and

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[3] Alfred Chandler Jr., *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, MA: Belknap Press, 1990); Michael Porter, *The Competitive Advantage of Nations* (Basingstoke: Palgrave, 1998).

[4] Rigas Doganis, *The Airline Business in the 21st Century* (London: Routledge, 2005); Stephen Holloway, *Straight and Level: Practical Airline Economics* (Aldershot: Ashgate, 1997); Peter Belobaba and Amedeo Odoni, "Introduction and Overview", in *The Global Airline Industry*, Peter Belobaba, Amedeo Odoni, and Cynthia Barnhart (eds.) (Chichester: John Wiley & Sons, 2009); Sean Barrett, *Deregulation and the Airline Business in Europe* (London: Routledge, 2009); William O'Connor, *An Introduction to Airline Economics* (New York: Praeger, 1989), Fourth Edition.

[5] For example, see Ray Stokes, "Chemical Industries: Changes in Products, Processes, Actors", in *The Oxford Handbook of Industry Dynamics*, by Matthias Kipping, Takafumi Kurosawa, and Eleanor Westney (eds.) (Oxford University Press, 2021); Geoffrey Owen, *The Rise and Fall of Great Companies: Courtaulds and the Reshaping of the Man-Made Fibres Industry* (Oxford University Press, 2010); Jeffrey Fear, *Organizing Control: August Thyssen and the Construction of German Corporate Management* (Harvard University Press, 2005); Takafumi Kurosawa, "Introduction: Industry history: Its concepts and methods", In *Industries and global competition: A History of business beyond borders*, by Bram Bouwens, Pierre-Yves Donzé, and Takafumi Kurosawa (eds.) (London: Routledge, 2018), pp. 1-24.

structural changes as they have occurred. The study, therefore, supports the scholarship on the importance of temporality within business history with the example of providing the most current changes within the airline industry.[6] This lends the study with a finer-grained analysis of industry and firm processes, going beyond the more focal, specific point in time, and "collective histories" approach featured by Chandler and Porter.[7]

6.2 State-owned enterprises

The study has showed how the state has been involved in the privatisation process and since. A continued presence of the state in the functioning of these flag carriers has been noted despite privatisation. For example, the study highlighted that strategic ownership and political ambivalence related to privatisation determined the AF ownership structure to remain with the state rather than the French flag carrier becoming fully private. Nonetheless, even flag carriers that have experienced full privatisation, including BA and Lufthansa, have had their governments intervene in times of need. The most recent COVID-19 bailouts exemplify how the state continues to be involved, even if indirectly in the case of BA, often leading to a "too big to fail" type scenario in favour of flag carriers. This aspect brings about concerns about government intervention and favouritism within the industry.

6.2.1 Government relationship with the flag carrier

The role of the state has transformed over time from a direct involvement into the flag carrier to a more indirect custodian-type relationship for the fully privatised flag carriers like BA and Lufthansa. Before the late 1980s deregulation drive, governments decided upon the aim of these airlines, negotiating agreements, and intervening within fare setting as well as procurement policies, among other. Despite privatisation, deregulation, and a general retreat from managerial decisions, governments like the UK and Germany have advantaged BA and Lufthansa, respectively.

[6] For example, see Stephanie Decker, "Introducing the eventful temporality of historical research into international business", *Journal of World Business*, Vol. 57, No. 6, October 2022, Article ID 101380; Robin Gustafsson, Mikko Jääskeläinen, Markku Maula, and Juha Uotila, "Emergence of Industries: A Review and Future Directions", *International Journal of Management Reviews*, Vol. 18, 2016, pp. 28-50; Daniel Wadhwani and Geoffrey Jones, "Schumpeter's plea: Historical reasoning in entrepreneurship theory and research", in *Organizations in Time: History, Theory, Methods*, by Marcelo Bucheli and Daniel Wadhwani (eds.) (Oxford University Press, 2014), pp. 192-216. These authors have embraced and advertised the benefits of capturing developments over time as a means of best explaining the nuances of how a firm and industry develops, as well as what stages exhibit the main drivers behind these developments. This study has highlighted how the late 1980s and 1990s were a period of pronounced transformation in the industry due to various privatisation processes, ranging from widespread deregulation to airlines and governments facilitating privatisation due to political and economic motives.

[7] Chandler Jr., *Scale and Scope*, p. 11.

Several examples have been featured here, including the British government advantaging BA in pursuing its scale strategy through the late 1980s acquisition of BCal and the German government effectively covering the VBL pension expenses to allow Lufthansa to proceed with flotation during the middle of the 1990s.

In cases like AF, government involvement continues more directly than in BA, Lufthansa, and other fully privatised flag carriers. This is done through the presence of a strategic stake, which despite partial privatisation and the KLM merger, has recently increased owing to the COVID-19 pandemic bailout. The French government has had a historic involvement in aiding AF through the early 1990 through a sizable bailout. The French state has also been ambivalent on how much to privatise AF despite 1980s promises of full privatisation under Balladur. This ambivalence and changes within government priorities ultimately decided the continued presence of the state in AF.

However, the main point here has been to show how, regardless of ownership, the flag carrier has been benefiting indirectly and directly (in the AF case) through its ties with the government. This has been exposed most recently by the COVID-19 bailouts, which attracted criticism from non-flag carriers. In this situation, a “too big to fail” type scenario has been observed, where governments intervened to protect their flag carriers due to the special historical relationship between them and the transport infrastructure concerns that may arise. This happened with other European flag carriers, including KLM, SAS, Finnair, TAP Portugal, TAROM, etc.[8] As such, this has been a widespread phenomenon, albeit uneven given that many non-flag carriers have not benefited from state assistance.

Questions may be posed then about the extent upon which airline liberalisation succeeded in its aims if there continues to be a prominent government presence within the industry, a post-1980s industry which has been built upon the aim and rhetoric of fostering competition for the good of the consumer? This is a compelling and ongoing discussion for business history investigation into state-owned enterprises.[9] This study has shown that the post-1980 deregulation drive has been successful to a great extent in facilitating competition and privatisation in the sector, resulting in the current “3C’s” industry framework.

[8] Several examples are presented in the Financial Times, *Europe forced to turn back clock to bail out airlines*, 9 May 2021.

[9] Several authors have already started posing questions about this aspect. For example, see Yusaf Akbar and Maciej Kisilowski, “To bargain or not to bargain: Airlines, legitimacy and nonmarket strategy in a COVID-19 world”, *Journal of Air Transport Management*, Vol. 88, September 2020, Article 101867; Megersa Abate, Panayotis Christidis, Alloysius Purwanto, “Government support to airlines in the aftermath of the COVID-19 pandemic”, *Journal of Air Transport Management*, Vol. 89, October 2020, Article 101931; John Macilree and David Duval, “Aeropolitics in a post-COVID-19 world”, *Journal of Air Transport Management*, Vol. 88, September 2020, Article 101864. These authors have warned about the intervention of aeropolitics through government advantageous bailouts dedicated to their flag carriers, therefore creating and imbalance in the market, where flag carriers will take-over a higher market share and deter new entrants. In this sense, these types of interventions may undo the deregulations progress since the 1980s.

Nonetheless, the cycle of bailouts and government favouritism has persisted when it comes to flag carriers regardless of their ownership. In this sense, limitations exist compared to the rhetoric on fostering competition, heard from governments like the UK. The role of the EU in facilitating government involvement must also be re-appraised as a facilitator of state involvement. This is discussed in the following section.

Overall, this study highlights the transformative yet ongoing role of the government within the flag carrier over time. This has been achieved by tracing the processes behind privatisation as they have occurred over decades. This perspective has yet to be discussed at length within business history and state-owned enterprises scholarship, which tends to focus on other industries, including public utilities like energy, railways, and telecommunications.[10]

This research also adds to the studies where the state-flag carrier relationship is considered by expanding the scope of the analysis to include the relationship between several governments and their flag carriers rather than the focus on the single flag carrier. It also discusses how these governments approached airline privatisation under different conditions.[11] By highlighting the examples of BA, Lufthansa, and AF and their governments, this study discussed the similarities and differences in terms of their relationships, including sales motivations, flotation steps, bailouts, and the protection of the flag carriers against competition. For example, the study has shown that British, German, and French governments aided their flag carriers by intervening through bailouts despite criticising each other for distorting competition. Therefore, this expanded scope allows for a better understanding of how the European carriers continue to have a special relationship with the state despite ownership changes.

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[10] For example, see Judith Clifton, Francisco Comín, and Daniel Díaz-Fuentes, "From national monopoly to multinational corporation: How regulation shaped the road towards telecommunications internationalisation", *Business History*, Volume 53, Issue 5, 2011, pp. 761-81; John Welsby and Alan Nichols, "The Privatisation of Britain's Railways: An Inside View", *Journal of Transport Economics and Policy*, Vol. 33, 1999, pp. 55-76; Mairi Maclean, "New rules–old games? Social capital and privatisation in France, 1986-1998", *Business History*, Volume 50, Issue 6, 2008, pp. 795-810.

[11] For example, see Bram Bouwens and Frido Ogier, *Welcome Aboard! 100 Years of KLM Royal Dutch Airlines* (Zwolle: W Books, 2020); Javier Vidal, "Latin America in the internationalisation strategy of Iberia, 1946–2000", *The Journal of Transport History*, Vol. 40, No. 1, June 2019, pp. 106-122; Joseph Amankwah-Amoah and Yaw Debrah, "Air Afrique: the demise of a continental icon", *Business History*, Vol. 56, No. 4, 2014, pp. 517-546; Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it".

6.2.2 The role of the EEC and the EU

The study portrayed the supporting role of the EEC and after 1993 the EU in facilitating deregulation and privatisation, but also in facilitating the relationship between government and flag carrier by means of allowing bailouts and state involvement. While the relationship between the flag carrier and government has been the focus, the EEC and later the EU have also backed-up the deregulation and privatisation agendas of national European governments. The EEC and the EU aided the move from bilateralism to multilateralism within the European setting, effectively creating the Single Aviation Market by the late 1990s. However, this study showed how several flag carriers received bailouts after approval by the EU, including the 1994 AF bailout, TAP Portugal, and Olympic due to the First Gulf crisis effects. This was met with criticism from BA and Lufthansa, among others, that did not benefit from such arrangements at the time.

Indeed, in these cases the EU supported deregulation and privatisation by allowing the bailouts to proceed in exchange for future rounds of divestures or landing slot transfers. In this sense, the EU has accomplished a balancing act of keeping the strategic European infrastructure of major flag carriers alive and well, while also attempting to foster competition and encourage new entrants, such as LCCs. As this study has shown, however, the balancing act has become increasingly difficult for the EU in the context of the pandemic bailouts, where the imbalance and the special ongoing relationship between flag carriers and national governments are most evident. Furthermore, the EU has approved alliances and mergers within the international context. Consequently, it has aided the consolidation of the industry. In this sense, the role of the EEC/EU has been more complex than a simple deregulation driver when flag carriers continue to benefit from favourable EU decisions, often to the detriment of new entrants.[12]

[12] See, for example, Ruud van Druenen, "Permission to bail out EU's national flag carriers? Technocratic and political determinants of commission approval of state aid to national airlines in difficulties in the pre-COVID era", *Journal of Public Policy*, Vol. 42, No. 3, September 2022, pp. 553-72. In this study, the EU involvement within the European airline deregulation drive before the COVID-19 pandemic is re-appraised to account for political factors beyond technocratic standards in determining bailout outcomes.

6.3 Privatisation processes

This study portrays the main processes behind airline privatisation. By considering processes, it expresses a different and more detailed perspective of airline privatisation than the widespread scholarship focusing on aggregate privatisation outcomes.[13] This study makes the case for including airline privatisation and specifically its underlying processes within the general privatisation scholarship as the industry has become increasingly important toward infrastructure, whereas airline privatisation has been treated as supplemental given its latecomer status.[14] Therefore, research into the airline industry and privatisation is especially encouraged to assess the most recent developments in the sector, and as a means of positioning the industry at the forefront of privatisation scholarship.[15]

6.3.1 Privatisation developments

This study has traced the principal developments at BA, Lufthansa, and AF over time in terms of the privatisation processes of restructuring, rationalisation, flotation planning, motivations behind the sale, change in employee status, as well as the involvement of international consultancies.

For example, this study has showed how BA served as an early example for many of these processes in terms structuring the sale, achieving an IPO flotation for an airline, involving airline employees as shareholders into the newly private flag carrier by means of offering discounted shares, and the use of consultancies to guide the flotation process. These elements have become the industry standard. As exemplified, Lufthansa and AF, among other airline privatisations, have followed in this standard, eventually leading to similar

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[13] For examples of aggregate privatisation outcome studies, see William Megginson, "Privatization, State Capitalism, and State Ownership of Business in the 21st Century", *Foundations and Trends in Finance*, Vol. 11, 2017, pp. 1-153; William Megginson and Jeffry Netter, "From state to market: a survey of empirical studies on privatization", *Journal of Economic Literature*, Vol. 39, 2001, pp. 321-389; Matthew Bishop and John Kay, *Does Privatization Work? Lessons from the UK* (London: Centre for Business Strategy, London Business School, 1988).

[14] The focus of privatisation research has mainly been on public utilities, including telecommunications and energy. For examples, see Michael Beesley and Stephen Littlechild, "Privatisation: Principles, Problems and Priorities", [1983], in *Privatisation and Regulation: The UK Experience*, John Kay, Colin Mayer, and David Thompson (eds.), (Oxford: Clarendon Press, 1986), pp. 35-58; John Vickers and George Yarrow, *Privatization: An Economic Analysis* (The MIT Press, 1988), pp. 7-45; Roman Frydman, Cheryl Gray, Marek Hessel, and Andrzej Rapaczynski, "When Does Privatization Work? The Impact of Private Ownership on Corporate Performance in the Transition Economies", *The Quarterly Journal of Economics*, Vol. 114, November 1999, pp. 1153-1191.

[15] Nonetheless, there have been several recent studies which have positioned airline privatisation and its processes in the spotlight. For example, see Bouwens and Ogier, *Welcome Aboard! 100 Years of KLM Royal Dutch Airlines*; Vidal, "Latin America in the internationalisation strategy of Iberia, 1946–2000; Amankwah-Amoah and Debrah, "Air Afrique: the demise of a continental icon"; Cozmuta, "Selling 'The World's Favourite Airline': British Airways' privatisation and the motives behind it". As such, there is scope for more discussion and research surrounding the topic.

outcomes—a successful sale attracting thousands of new shareholders and new investments into aiding the flag carrier's scale strategy.

In the process of privatisation and because of flotation, this study has drawn attention to the phenomenon of airline employee status change from civil servants to employees and new shareholders. BA, Lufthansa, and AF have all advertised the success of attracting their employees as shareholders in a strategic manner. Mainly, the employees now became more directly involved in the process of creating and reaping value from their involvement with the flag carrier. At the same time, a high worker participation in the flotation signalled to potential outside investors that the flag carrier was a more secure, stable, and attractive investment proposition, even if that has not always been true.

Over time, there have been many union actions at these airlines since privatisation. Nonetheless, the majority of employees have taken part in the flotation process and ultimately in the ownership of BA, Lufthansa, and AF. This has been true with other flag carriers too, including KLM, Iberia, SAS, etc. In this sense, employee participation has been common as part of privatisation and as an outcome of flotation. The specific developments and how this has affected the incentives and job security of the new employee-shareholders have not been the purpose of this study. Nonetheless, these aspects and more (e.g. relationship with the new private owners, gender disparities, etc.) are worthy of future investigation, especially since not much is yet understood about how the priorities of employees and private ownership align or diverge in the context of the airline industry.[16]

However, this study has also highlighted differences in the privatisation process between these carriers. Politics and state priorities especially mattered in terms of the motivations for the sale, the pace of privatisation, and ultimately the outcomes. The study discussed how the early motives for BA were economic due to the inefficiency at the airline, but also the PSBR limits on public borrowing imposed in the wider British economy. As the situation at BA improved due to King's quick recovery plan and that in the British economy under Thatcher, the motive for the sale developed to focus on widening share-ownership by deliberate share under-pricing. This ideological pursuit was seen as advantageous for the Conservative political support of the late 1980s.

In contrast, the German government chose a third-way and gradual approach to the Lufthansa sale, where practicality preceded economic and ideological pursuits. The German

[16] Helena Falkenberg, Katharina Näswall, Magnus Sverke, and Anders Sjöberg, "How are employees at different levels affected by privatization? A longitudinal study of two Swedish hospitals", *Journal of Occupational and Organizational Psychology*, Vol. 82, 2009, pp. 45-65; Goutam Kumar Kundu and Bidhu Bhusan Mishra, "Impact of reform and privatisation on employees a case study of power sector reform in Orissa, India", *Energy Policy*, Vol. 45, June 2012, pp. 252-262; Bat-Sheva Druk-Gal and Varda Yaari, "Incumbent employees' resistance to implementing privatization policy", *Journal of Economic Behavior & Organization*, Vol. 59, March 2006, pp. 374-405.

government believed that profitable companies were best left to the management of private sector ownership. Nonetheless, the Lufthansa privatisation was gradual and passive at first through more timid divestures via government share dilution on rounds of Lufthansa capital raising. This gradualness was due to political opposition within and without the government. On the conservative side, opposition argued that a private Lufthansa would renounce its national duties of acquiring Airbus aircraft and supporting Bavarian manufacturing. On the liberal side, criticism was directed at the slow pace of privatisation planning. As the conservative opposition subsided with a change of leadership and with the realisation that Lufthansa's Airbus acquisition policy was not endangered, the government and Lufthansa resumed a more active approach to flotation under the Weber leadership. The full divesture in Lufthansa was finally realised by IPO in 1997.

Compared to the British and German governments, the French government was the most ambivalent in its practices with AF. In the late 1980s under Balladur as the Minister of Finance, the French government advertised ideology and widening share-ownership as aims for its privatisation programme, in a similar way to the British government. Yet there were no specific measures taken for this and the aim dissipated as the economic concerns of balancing a French budget concerned with borrowing took over. When AF was finally announced for privatisation in the early 1990s, the French government was most forthcoming about these economic motive for privatisation. However, a change of government to the socialist Jospin leadership impeded the full privatisation of AF once desired by Balladur. Yet this ambivalence continued even after Jospin and throughout the early 2000s Raffarin government when further rounds of divestures in AF were promised. However, the most recent merger with KLM and the increase in ownership due to the COVID-19 bailout have signalled that the French government has historically remained ambivalent, and recently even against the idea of completely divesting from AF due to strategic reasons. In this sense, this study has shown that political incentives and motivations have also shaped the airline privatisation process, and they have continued to influence the industry even after.

6.3.2 The involvement of international consultancies

There has been a cross-national dimension to the airline privatisation process, which this study has highlighted. This has been represented by the involvement of the largest international consultancies. While the detailed involvement of consultancies and the relationships these have built with the governments and airlines themselves have not been the priority of this discussion, their presence has nonetheless been felt.

The study has showed how international consultancies like Morgan Stanley, Lazard, Goldman Sachs, and others advertised themselves to governments as a means of acting as auditors, brokers, underwriters, sale advertisers, and flotation planners for the British, German, and French airline privatisation experience. They have often used their previous experience as a selling and advertising point. In this sense, they propagated the IPO model for airline flotation. For example, the study noted the "Beauty Contest" list of consultancies prepared by Lufthansa and the German government in Picture 4.6 from Chapter 4. This list was essentially an "interviewing" opportunity for these consultancies for the position of helping with the Lufthansa privatisation.

In the cases of BA, Lufthansa, and AF, it has been revealed that similar consultancies were involved in the privatisation process, including Kleinwort Benson, Lazard, and Nomura. However, this study also highlighted how consultancies propagated their airline privatisation expertise by actively seeking out other governments and flag carriers to offer their services to, including the governments of Greece, the Netherlands, and Spain. Indeed, the consultancy phenomenon has been studied extensively with regards to the finance, manufacturing, and technology sectors.[17] However, it is also worth considering how these large consultancies shape the airline industry and future airline privatisation processes. However, as the study has highlighted with the AF example, detailed material related to the role of these consultancies within the privatisation process remains classified and difficult to obtain given their private and confidential character. Nonetheless, the involvement of consultancies remains a point for further research that business and management historians alike may be interested in.

6.4 Further avenues for research

There are other important research questions which may arise from this study. These may be of interest for future research.

6.4.1 Flag carriers as national symbols

One aspect which has been present in the background throughout this study despite not being directly connected to the privatisation processes, is the concept of flag carriers as national symbols. In this sense, further research may uncover more about this special relationship between flag carriers and governments from the perspective of media portrayal and exposure, but also from the context of flag carriers as national representatives abroad. Delegates, sports teams, and artists have used flag carriers at important events, where the

[17] For example, see the works by Matthias Kipping, "American Management Consulting Companies in Western Europe, 1920 to 1990: Products, Reputation, and Relationships", *Business History Review*, Vol. 72, No. 2, Summer 1999, pp. 190-220; Christopher McKenna, "How Have Consultants Mattered? The Case of Lukens Steel" (Chapter 3), In *The World's Newest Profession: Management Consulting in the Twentieth Century* (Cambridge University Press, 2006), pp. 51-79.

airline receives every bit of publicity as the passengers it carries (e.g. Phil Collins famously flying the BA Concorde for the 1985 Live Aid performances between London and Philadelphia. The separate performances took place within a few hours of each other, although the BA logo and name were prominently featured on many international broadcasts owing to this impressive feat, Picture 6.1).

Picture 6.1 Musician Phil Collins with his then-wife, Jill Tavelman, preparing to fly to Philadelphia as part of the Live Aid event, 13 July 1985.[18]

Therefore, research may consider how flag carriers have contributed to or have been used as instruments for nation building and national identity, using various methods ranging from sociology to semiotic research.[19]

6.4.2 The interior dynamics of airline mergers

Another aspect to consider for future research due to the importance of airline mergers to the consolidation of the industry are the interior dynamics within which international airline mergers like IAG, AF-KLM, and the Lufthansa Group operate. There have also been cultural and managerial differences leading to tensions within the AF-KLM merger. To this day,

[18] Picture copyright belongs to The Telegraph, featured in *The 15 most momentous flights in British Airways' history*, 1 August 2019.

[19] For example, see K. Raguraman, "Airlines as instruments for nation building and national identity: case study of Malaysia and Singapore", *Journal of Transport Geography*, Vol. 5, No. 4, December 1997, pp. 239-56; Crispin Thurlow and Giorgia Aiello, "National pride, global capital: a social semiotic analysis of transnational visual branding in the airline industry", *Visual Communication*, Vol. 6, No. 3, 2007, pp. 305-44. These authors have explored the concept of flag carriers as national symbols by examining visual representations of aircraft tailfins and branding.

these tensions have not been fully resolved given the ongoing disagreements between the French and Dutch governments over ownership. Nonetheless, the AF-KLM merger has been successful compared to the infamous Daimler-Benz and Chrysler merger. Less is known about the interior dynamics of IAG or the Lufthansa Group, although the media has often portrayed airline mergers as problematic.[20] The reasons for these incompatibilities are not well understood or explored within scholarship, especially given the flag carriers relationship with their governments and how this may change the culture within the flag carriers and mergers. With more consolidation in the industry and the establishment of other mergers not just within Europe, there is a compelling reason to expand the scope for research among business and management historians to understand the dynamics within these airline international mergers and why they may lead to issues.[21]

6.4.3 Linking airline industry research with wider debates

At the same time, this study encourages more purposeful linkages between airline industry research, privatisation, and state-owned enterprise scholarship with wider debates within business history. In Chapter 1, this study proposed alternative theoretical approaches for a wider discussion surrounding this industry and the business systems it encompasses. For example, the Varieties of Capitalism debate positions the UK as having the characteristics of a liberal market economy, Germany as a coordinated market economy and, more recently, France as being driven by state capitalism.[22]

However, this study has shown that the debate goes beyond the typologies present in the Varieties of Capitalism debate by being highly dependent on the industry dynamics within the sector discussed, but also due to the importance of temporality in this analysis. This study showed that the state continues to be involved in flag carriers and the airline industry regardless of the typology of capitalism. However, this study has also highlighted that flag carriers operated and encountered similar challenges before the 1980s deregulation

[20] BBC, *Are mergers good for airlines?*, 4 May 2010.
[21] There is a surprising lack of research on this topic related to the airline industry, with most recent interest coming from the U.S.. For example, see Julia González, Jorge Lemus, and Guillermo Marshall, *Mergers and Organizational Disruption: Evidence from the US Airline Industry* (Work in Progress, 22 November 2022), pp. 1-34; Adams Steven, Amirhossein Yazdi, and Martin Dresner, “Mergers and service quality in the airline industry: A silver lining for air travelers?”, *Transportation Research Part E: Logistics and Transportation* Review, Vol. 89, May 2016, pp. 1-13. The authors highlight that airline mergers with organisational challenges, specifically here related to the U.S. case, may lead to organisational disruptions, lower service quality, and ultimately affect financial performance for the firms. It is suggested that antitrust authorities should consider a merger’s organisational challenges in the review process.
[22] Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001), pp. 1-68; Niall MacKenzie, Andrew Perchard, Christopher Miller, and Neil Forbes, “Business-government relations and national economic models: A review and future research directions in varieties of capitalism and beyond”, *Business History*, Vol. 63, No. 8, 19 May 2021, pp. 1239-52; Vivien Schmidt, “French capitalism transformed, yet still a third variety of capitalism”, *Economy and Society*, Vol. 32, No. 4, 2003, pp. 526-54.

drive despite being associated with different governments with different priorities. In this cases, it is important to consider how temporality and changes over time influence the debate.

Furthermore, this study has exemplified that competition and cooperation co-exist in the industry rather than being specifically divided and associated with one typology (i.e. the liberal market economy being characterised by increased competition between economic actors) or another (i.e. the coordinated market economy being associated with increased collaboration between firms).

At the same time, Chapter 1 proposed the bandwagon theory as an alternative theoretical approach to explain how industry standards became widely adopted within the industry through actors and the scale strategy. The presence of cross-national consultancies in the privatisation planning process and the wider propagation of the IPO model among flag carriers is an example of the actors involved as part of the bandwagon approach. The scale strategy emerged as the main strategy of growth and cooperation due to the pressures of competition. BA, Lufthansa, AF, and other flag carriers embarked upon this scale strategy with similar aims, fostering cooperation by means of code-sharing agreements, cross-investments, and takeovers. In this sense, the intra-firm strategy informed developments within the industry. This led to the establishment of the "3C's" framework as described in chapters 3, 4, and 5.

Further research on other industries and even more detailed study within the airline industry may add to these alternative theoretical approaches, offering a more nuanced interpretation of existing Varieties of Capitalism and the bandwagon theory, perhaps even advancing the framework beyond national boundaries as firms and industry have become exceedingly global.

6.4.4 Assessing the outcomes of the COVID-19 pandemic and re-appraising the role of institutions

Last but not least, the COVID-19 pandemic outcomes should concern policy-makers and researchers in several ways.

First, the bailout effects for flag carriers may create or exacerbate imbalances within the industry. In this sense, researchers may consider how governments and organisations like the EU can intervene to contribute toward more equitable bailouts or measures destined to distribute aid more fairly to non-flag carriers.

Second, the phenomenon of "too big to fail" has been exposed due to the pandemic. Researchers may compare and contrast how this relates to other industries and the different ways governments have continued intervening to allow this to happen.

Last, attention may be given to how the industry and flag carriers recover from this crisis from the perspective of alliances. To what extent will the balance of power (or market share) change in light of recovery related to the main alliances? What lessons will this event have for non-flag carriers? Will there be reactions of consolidation from non-flag carries as precautions against future crises? These are some of the main questions that can be considered.

Overall, this study has presented the reader with the main processes behind the privatisations of the largest European flag carriers. Readers and scholars alike will have appreciated that flag carriers and the airline industry encountered pronounced changes in the past several decades. Yet many of these changes have often gone undocumented or overlooked. Above all, it is hoped that the research presented in this work has contributed to a better understanding of the processes, dynamics, and outcomes of these developments.

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