

Beyond the Deal Newsletter

***Mergers and Acquisitions that
Achieve Breakthrough Gains***

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Building a Three Legged Stool for Integrating the US Airways/American Airlines Combination: The Making of the World's Largest Airline

Quote of the Month

"If US Airways and American Airlines merge and they don't heed the lessons of past blunders, then the integration process could set back the new American Airlines for years, new logo and livery or not."

Dennis Schaal, News Editor, skift.com

In the last two issues of the Newsletter we explored how INC Research's acquired and successfully integrated Kendall International. Think about the transparency, collaboration and rigor of how INC Research leadership and compare it with the integration prospects of the current \$11 billion acquisition by US Airways of American Airlines. The major thing that is the same is that a smaller organization (US Airways) is acquiring a larger one

(American). Beyond that there are significant differences. The leadership styles, culture, financial conditions, make-up of the workforce, strategies and other factors are quite different in US Airways and American transaction.

The INC/Kendall is a model for how to carry out an integration but the USAirways/American acquisition is far more typical of how the majority of acquisitions take place.

This Newsletter looks at the upcoming integration as a stool that is supported by three legs. The first leg is leadership. The second is stakeholders (in particular union pilots) and operations. The third leg encompasses the larger trends towards consolidation and restructuring that are occurring globally and which set up the context for the forces affecting the newly combining airline today and into the next decade. If all three legs are sound, the integration should go forward and be successful at transition to the new American Airlines. If anything is amiss with any of these legs, the integration will falter.

If the past is a prelude to the future, the deal will go through, and over time the two airlines will be integrated. However, judging from past behaviors, this will be a shotgun integration, with significant conflicts continuing to simmer for years after the official integration has been completed. Is this necessary? No, it is not. It is based on the operating philosophy of the acquirer and the leadership of both companies. If a positive integration process is to take place it will flow from the CEO level. Will the CEO's be more concerned with getting the finances working or will they take a more comprehensive view, see that this a unique opportunity to take two companies and make them into a new airline that goes beyond what would be possible by each airline going along on its separate way?

Keep an eye on how this acquisition plays out. Also look at how the United-Continental, Delta-Northwest and Southwest/AirTran integrations have gone, where they have succeeded and where the rough spots in the transition were.

You can also access the first section of this conversation at: www.beyondthedeal.net/NewsletterMarchApril13.pdf

Building a Three Legged Stool for

Integrating the US Airways/American Airlines Combination: The Making of the World's Largest Airline

Three Core Legs Supporting the Successful Integration Stool

The \$11 billion US Airways-American Airlines combination will result in the formation of the world's largest airline and one of the three US full service carriers with transatlantic routes.

Three elements are shaping how this combination and integration will happen and how successful it will be. Each element can be seen as a critical leg supporting a successful integration stool. The first key leg is the driving personality of the US Airways CEO, Douglas Parker. The second is how well the specific challenges involved in combining these two organizations are addressed. And, the third is how the new airline takes into account the global trends that all airlines - large or small, domestic or international - have to cope with now and over the next decade.

The Parker Factor

Doug Parker has been CEO of US Airways for the past eleven years. When he first became CEO of America West, the airline had the nickname of "America Worst". Parker was driven by the goal of making the airline a viable and financial success. To do that he has tangled with unions, instituted a series of passenger fees, and sought to acquire other airlines so it could become a more significant player in the American and international market. He did not come to be CEO of US Airways via the more traditional pathway of being an aviation enthusiast. Parker's background is in finance, and his view is that "From the time I started in this business, people would say, 'It's the airline business; it's romantic and we don't make money...but none of that ever made sense to me. It's not romantic. It's bad business.'"

Parker's focus is on his vision of airline operational profitability and on

consolidation with other airlines so that it can become the premier competitor in its space. Under Parker's leadership America West acquired the much larger, but troubled US Airways in 2005 and is now acquiring American Airlines, again a far larger but also troubled airline. Using passenger traffic as a measure, US Airways is only half the size of American, and it is fifth in overall size versus American's number three rank. Consistent with his experience in America West's integration with US Airways, Parker has stated that his goal is to achieve the best industry financial benchmarks in newly combined American Airlines in only three years.

Parker has the vision, determination and persuasiveness to lead the newly emerging airline to achieve his goals. He successfully reworked US Airways to lead it to become a profitable airline and attain a much improved on time arrival rating. At the same time a core question remains as to whether he will successfully resolve the difficult and thorny problems that an integration with American will bring to the integration table.

High on that list is working through the seniority list issues that will now include the legacy America West and US Airways pilots' unions as well as American's pilots' union. The two legacy groups of both America West and US Airways pilots and flight attendants continue to have antagonistic relationships and contribute to a divisive undercurrent that has existed since they combined in 2005. When America West acquired US Airways it failed to move to one labor contract, forcing the different union members to continue to operate with separate work rules and pay scales - a very unsatisfactory situation.

While American pilots approved the upcoming merger, American pilots also have had their own chronically adverse relationship with American's executives, allowing US Airways the opportunity for it to be considered to be a white knight acquirer.

Even so, Parker and his leadership team's history and recent comments indicate that they will likely not make staff integration and service agreements a highest ranked priority in the integration. Instead, financial and operational viability will be the top items and employee and customer retention will be dealt with as need be.

Parker has clearly stated his view that ""Management teams get wedded to their systems and processes. We've stolen the 'adopt and go' approach from Delta - Just get yourself running by adopting the larger airline's processes and just go. We need to get the integration done.""

Signed, Sealed and Delivered Seniority Integration Agreements

The second leg supporting the integration stool requires getting a handle on integrating US Airways' and American Airlines' pilots, flight attendants and other labor groups. This is an element that could well be the game changing issue, either in a positive or negative way. This is at the core of the integration of the two airlines. Even with good senior integration agreements it is estimated that, with all of the labor, technological and logistical issues to sort out, the full integration of the two companies into one will still take years, and according to one estimate - four years to complete - and the stakes are extremely high.

[Former American CEO, Bob Crandall](#)^[i] was very specific on this when he said that, "I favor a merger subject to a big 'if' - and, that is - a signed, sealed and delivered seniority integration agreement amongst all pilots, US and American, before a merger occurs. Unless such an agreement is in place a merger does not make sense."

Crandall continued that, "Any airline merger is complicated. To make it work, everyone on the property: management, pilots, fleet service, mechanics, flight attendants and everyone else has simply got to work together to make the consolidation as smooth as possible and to assure customers that they will have industry leading service. Without a seniority agreement that won't happen.

"Without cooperation the merger will fall far short of expectations and might even cause such serious problems that the company could fail again. That is especially true in the case of American and US since these two systems will not come together in quite the same way as Delta-Northwest or United-Continental, which were substantially more end-to-end than American/US."

Crandall went on to say that, "To take advantage of the revenue and cost synergies in the American/US combination, both networks will be substantially changed. Without an affirmative vote approving the seniority integration plan, I am very concerned that bitterness and anger will undermine the spirit of cooperation that I think is absolutely essential for success. That is particularly true given the acrimonious and long unresolved pilot integration situation at US Airways. "

The American pilots union has agreed on a transitional contract and a system to handle seniority integration. US Airways flight attendants took until February 28, 2013 to approve their first joint contract after rejecting two prior accords. It is worth maintaining a cautionary view here since the

groups involved in these conflicts have a long and discordant history and any preliminary transition agreement could unravel as the combination arrangement continues.

Acquisitions are often one of those unique circumstances where a "window of opportunity" temporarily opens during for working through issues that might otherwise be intractable. Although a senior integration agreement might not have been possible before - it may be possible to achieve this at this specific juncture when all parties expect and are open to a change in the status quo.

Sensing this opening, Keith Wilson, president of the Allied Pilots Association representing American pilots, has said that, "Under new management, the new American Airlines has the opportunity to change the broken culture that we have suffered under and compete on a level playing field with Delta and United. And that means a secure future for all pilots."

Wilson also commented that he expects "we are twenty-four to thirty months from combining seniority lists of American Airlines and US Airways" and counseled his membership not to be anxious about that for some time into the future.

Another factor that may be in play here is that Doug Parker utilizes Bob Crandall as a sounding board. These conversations may provide the opening and support for Parker and his leadership team to revisit their priorities and give its employee agreements the same status level as its goals for financial and operational viability.

Some Guiding Points

Both US Airways and American have made significant blunders in previous integrations. The question is whether they will learn from their past integration bumbles as they move forward on their upcoming integration.

A valuable opportunity to modify the new American integration model can occur by drawing lessons from the Delta-Northwest and United-Continental airline integrations within the last two years.

On the positive side, the new American Airlines could learn from the "relatively problem free Delta merger and migration...Delta now has a single revenue management system for the combined airlines. Additionally, and beyond the nuts and bolts of getting the technology right, Delta did a great

job of retaining key people from Northwest and sharing best-practices and procedures across both airlines, says Henry Harteveltdt, travel industry analyst at Hudson Crossing.

There are also lessons about "what not to do" in a merger of this scale. Harteveltdt continues,

"Continental ran the show in the United-Continental merger, and was dismissive of a lot of what United was doing, including its Economy Plus seats, which the merged United eventually adopted. There was a huge amount of arrogance on the part of Continental Airlines."

Harteveltdt sums things up with this comment, "Parker and Kirby, if they are heading the combined American Airlines-US Airways, would be wise to take the best from US Airways, including their skills in turning a profit, and also take advantage of American's superior attributes, including technology infrastructure and marketing prowess."

Will the leadership of the new American Airlines choose to take advantage of these learnings? Or will it primarily decide to look inward and rely on repeating what it has done as its default set of priorities and actions once again? This choice will have significant consequences for how well and how quickly the upcoming integration takes place.

Drivers for Consolidation and Integration in a Changing Economic Context

The third leg of the merger integration stool is how the global pattern of consolidation and restructuring is affecting all airlines. These long term and long reach influences are shaping the environment for the newly reconfigured airline as goes through its integration process. The contextual forces are not getting much attention but they can determine the extent to which the new American Airlines will be successful or if it simply becomes a "Rube Goldberg" organization cobbled together from the various pieces of its legacy troubled organizations.

Lida Mantzavinou, a Frost and Sullivan commercial aviation consultant, noted that over the last five years the airline industry has witnessed a strong wave of consolidation in an attempt to generate profits from synergies, cost-efficiencies and economies of scale. Since 2008, these challenges have led 375 airlines around the world to cease operations, twice the number of airline start-ups.

Even so, Mantzavinou says that the industry is still considered to be very inefficient, and that that will lead to the forces for continuing consolidations to intensify over the next few years.

Although US Airways and American leadership has stated that most of the loss of positions in both companies will be redundant senior leadership positions, the global trends project that what will more likely happen in the integration process will involve major restructuring changes, including the unification of revenue management processes across an airline group's global locations, coordination of flight schedules and redeployment of aircraft, but also sizable staff reductions. Staff count and staff expenses are an obvious target since that after fuel costs, staff are the airline's second highest operating charges.

In keeping with this, financial gains coming from the airline group restructuring are expected to be realized from changes in with union agreements and any other group synergies that materialize. This makes it even more imperative that seniority integration agreement be satisfactorily put in place in the very near term. Otherwise the same unfinished situations will come to haunt the new airline as has been the case with US Airways

Further, there is one important global element that has not gotten much attention to this point: the platform of cross border partnerships. Yet, these the ability to cultivate and leverage these partnerships will play a significantly role over time in determining the whether the new American Airlines combination will develop a competitive edge in its race with United-Continental and Delta-Northwest. All of these airlines will be seeking to strengthen their position globally through collaboration with the foreign partners within their alliances.

Widening Options and Making the Best Decisions

In their book *Decisive*, Chip Heath and Dan Heath argue that choosing from a fuller range of real (i.e., not sham) options will yield significantly higher yield outcomes. Many leaders put a proposal on the table that is in effect a *fait accompli* and not a subject for open consideration. The new leadership of US Airways-American has the opportunity to widen its options beyond the either/or of raising profitability versus tending to other issues (seniority integration agreements, etc.). By uncovering a fuller range of options it may discover that it can incorporate more of these key issues as parts of a more linked approach during the integration. Doing so could give the new American the chance to accomplish its particular profit goals as part of its

overall set of goals. Doing do so in might well yield an unprecedented leap in productivity, in value creation and in problem resolution.

Each of the three legs of the stool involves the key players and the issues that will shape the new American Airlines organization. While it is easier to focus on one or two of these factors at a time and to skip the others, neglect of any of these three will create a shortsighted view and an incomplete integration. Each factor needs to be recognized and dealt with regarding its actual impact and dynamic.

For example, overlooking the importance of developing the capacity to be an international carrier, for example, will affect the amount and types of resources that can be deployed to produce the levels of service and global reach for the both passengers and goods with international destinations. Being innovative and effective in accomplishing global reach, providing amenities and achieving cost efficiency could set the new American apart as the standard for all airlines around the world.

While integration playbooks and supporting integration technologies are certainly essential to make the transition to the new American happen, they must be seen as part of the larger undertaking. They need to be aligned with building capabilities in strategic vision, supporting values and working practices with which American can more rapidly respond to its changing conditions. The upcoming integration is the first step in that process.

Footnote: A Valuable Resource for US Airways-American Consolidation and Integration Developments

www.skift.com may provide the best ongoing updating of US Airways-American Airlines consolidation news. It is designed to be a platform for both professionals in the travel industry and for business travelers. Take advantage of that by signing up for a free subscription.

[i] [Bob Crandall video on his appraisal of combining US Airways American Airlines:](http://www.youtube.com/watch?feature=player_embedded&v=-mJUyYskVYI)
http://www.youtube.com/watch?feature=player_embedded&v=-mJUyYskVYI