Exploring Post Merger Integration Challenges Through the Airline Industry

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In a how-to piece a few years back, an executive consultant mapped out his vision of an ideal integration schedule. By the end of one year, he insisted, “even the largest acquisitions” should be completely integrated. Rarely is that timeline accomplished, and for good reason when you look towards the airline industry as a case study in post merger integration.

Alaska Air Group Inc. announced in April it would acquire Virgin America Inc., the latest in a string of such mergers stretching back decades. Those deals mark an intense consolidation in the U.S. over the past several years by so-called legacy carriers, the old-line airlines that fly throughout the country and the world. Nimbler, low-cost carriers such as Southwest and Alaska Air are fighting back with mergers of their own, as competition intensifies, excess capacity is pared, efficiencies honed and networks expanded.

After each transaction, the same question comes up: How should the partners combine their operations? Maybe the best answer: slowly and methodically.

“It’s a long, long process,” said Paul Mudde, a management professor at Grand Valley State University, in Grand Rapids, Mich., who studies airline mergers. “How fleets work together, how personnel works together, how IT works together, how everything else works together.”

Airlines take years to become one entity. And there’s no evidence that integration is getting any quicker, less complicated or any less expensive as time goes on. While Alaska Air and Virgin America look like a good fit, there’s no reason to believe the two carriers can substantially speed up the integration process. Nor should they try.

“Don’t rush it,” is the advice of John Thomas, who leads the global aviation and travel practice at consultancy L.E.K.

Alaska Air and Virgin America executives acknowledged a lengthy and expensive integration when they announced the deal. They project the merger will be accretive to earnings during the first year but that it will take until 2019 to achieve 90% of the $225 million in projected annual synergies. The integration will cost Alaska Air upwards of $350 million, executives said.

Alaska Air CEO Brad Tilden talked confidently of a more competitive, stronger and more financially powerful airline after the merger. Analysts are, on the whole, upbeat about the merger. “Virgin and Alaska are two strong organizations and a couple of the better airlines in terms of economics,” said Joe Aberger, the president of merger integration firm Pritchett LP.

However, many studies underscore a sobering reality about deals in general. At least half of all mergers fail to achieve financial goals that executives project and that shareholders expect. And integration is one of the biggest determinants of success or failure in any industry. A subpar integration effort often leads to subpar returns. Trying to save money by cutting integration costs is a recipe for disaster. An inadequate or poorly planned integration brings out the
worst in an organization, revealing fissures that under less stressful situations may have been less pronounced.

“Mergers exacerbate pre-existing conditions,” said Joe Aberger, the president of merger integration firm Pritchett LP.

By contrast, a successful integration can spur combined organizations to achieve even more than they could individually. Everyone–shareholders, employees, and customers–benefit.

“When mergers and acquisitions work, the integration process seems to be holistic, fluid and well executed,” noted the executive coaching company 1-Focus.

Post-merger integration is tough in any industry. But airlines face an especially complex challenge and bad results can be embarrassingly public.

“Airlines on a magnified level expose all of the pain points and challenges that companies across all industries during the PMI process” that occur across industries, said Ben Collins, director of strategy and product marketing at Intralinks Inc. “They’re so evident and so real.”

They’re also clearly visible. “If a reservation system is not synched properly, I feel it, you feel it, and my kids across the aisle on that plane feel it,” said Collins. “If a steel company doesn’t get one plant aligned with another plant and takes four months instead of three months, well, OK. But if there are lines out the door at the check-in desk that’s going to make the headlines.”

Despite the long history of airline consolidation, the job doesn’t seem to get any easier. That’s especially true when it comes to IT integration, the single most critical element in an airline merger. “It’s getting more complex as time goes on and it’s just going to get worse,” said Carlos Melendez, the COO and co-founder of the software integration firm Wovenware.

The merging entities face a huge quandary: While integration must be methodical, an overly long transition time can itself make the predicted outcome more difficult to achieve. In the interim, technology can advance. The marketplace can shift. Consumer habits can change.

“They’re dealing with a moving target,” said Mudde. “Challenges are evolving and each year that goes by post-acquisition complicates matters.”

“Between the day that a deal is announced and when the two entities are fully merged, “the whole value proposition may be different,” added Aberger. An economy, once booming, could be sputtering, depressing travel demand. Or fuel prices could have risen or fallen dramatically in the intervening time, substantially altering operating costs and fleet projections.

What’s more, Aberger said, the longer integration lasts, the task of keeping employees upbeat about the prospects of the merged entity gets harder. “People begin to doubt whether the merger makes sense,” he said.

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Ben Collins, Intralinks

There’s also a long period often years when the two entities remain separate, but connected. Systems run in parallel and what is termed “interim functionality” must be strong and dependable. So, for example, a particular flight may be sold by both merging airlines, each using their own reservation systems and their own brand, but they are linked, so customers don’t suffer.

The whole process calls for careful planning and methodical implementation, neither too fast nor overly plodding and indecisive. “There’s a balancing act between achievement on a timetable and being judicious,” said Collins. “There’s a lot on the table. When to put things into action is a complicated decision tree.”

Of course, the importance and complexity of each of those categories vary from industry to industry. A plastics manufacturer has fewer issues with brand than, say, a fashion retailer, but proper machinery is absolutely essential.

Increasingly, however, IT must be front-and-center in almost any post-merger integration. “It’s the underlying foundation,” said Collins.
With airlines, that dominance is even more pronounced. “I can’t think of any other industry that has that kind of complexity,” said Melendez. “And it’s just growing.”

The reservation system becomes the face of airline integration, at least for consumers. But it’s only one of many systems that must work when integrated and work in concert with others. There’s frequent flier programs, baggage handling, cargo, maintenance, personnel scheduling, equipment deployment and gate operations.

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Carlos Melendez, Wovenware

Add to that the essence of what an airline does-connect people to different locations. Each airport has its own systems. Each country has its own standards and peculiarities. “There are so many moving parts,” said Melendez.

Merging all those separate systems between combined airlines so they work together and across functions is immensely complicated. It’s also dependent on widespread cooperation. Poorly trained reservation agents or uncommunicative IT technicians can ruin a years-long effort. One software integrator who worked on the merger of Air Canada and Canadian Air in the early 2000s described an aborted systems switch in one airport because a single software engineer “claimed he didn’t get the memo” about a necessary task.

Then, there’s the evolution of technology itself. “It’s not only merging one system into another, it’s being open to embracing new technology that’s coming down the pipeline,” said Melendez.

United Airlines and Continental became the poster child for bad integration. The combined airline and its customers still suffer the ill effects more than a five years after the merger was announced in 2010. Last November, on the fifth anniversary of the merger, Oscar Munoz, United’s new CEO, took out full-page ads not to gloat but to apologize. “This integration has been rocky. Period,” Munoz told the Wall Street Journal at the time.

United Continental experienced reservation breakdowns years after the two airlines went on a single reservation system in 2012. One day in 2015, an IT systems snafu prevented passengers from being
checked in and caused thousands of flights to be grounded.

Bad decisions at the top worsened and compounded the difficulties. Not only did the two airlines need to merge two completely separate systems, but management decided on the SHARES system, which was used by Continental, instead of United’s much larger Apollo system. SHARES had never been tested on such a massive scale. When the switch was made, SHARES couldn’t handle the increased transaction volume, with slowdowns and computer freezes commonplace. Inadequate training only worsened the situation.

"Changing the core system of the main airline makes everything that much harder," said Melendez.

In the case of Alaska Air and Virgin America, both airlines use the same reservation system provided by Sabre Corp. So integration should be far smoother, outside analysts believe.

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“Having a common reservation system clearly increases the ability to merge systems,” said Thomas.

What’s more, the airline industry has moved much more to open-source technologies than in the past, when in-house and proprietary technologies ruled the skies. And outside technology, like airport kiosks, are more geared to multiple airlines now than in the past.

While IT may top the list in terms of difficulty and importance, airline integration involves far more than getting the technology in good working order. Serious personnel issues, for example, have bedeviled United Airlines, and not just rivalry between staff of the two merging airlines. During that merger integration, “some conflicts came out within each organization,” said Mudde.

In his interview with The Journal, Munoz highlighted those personnel woes, which have resulted in low morale, labor strife and poor customer service. He described the 85,000 employees as “disengaged, disenchanted, disenfranchised.”

Equipment differences can also greatly complicate a merger. According to Mudde, legacy carrier mergers such as United-Continental, American Airlines-US Airways and Delta-Northwest combine fleets with as many as 40 different aircraft types. That variety raises questions about which planes should fly where and which ones should be permanently grounded. Pilot deployment and spare parts issues also come into play. The Alaska Air-Virgin America also presents an equipment issue. Alaska Air deploys Boeing-made 737 planes while Virgin America flies a fleet of Airbus 319s and 320s.

Part of that difficulty stems from merger rationalization. Two merging airlines that expect to save money by slashing overlapping operations and rationalizing fleets face a more difficult task than airlines that are complementary in where they fly, making growth the main impetus for the combination. Integration is likewise more difficult when merging airlines in a particular airport must combine operations than when an acquiring airline simply absorbs the target’s existing operations under the new banner.

That complementary approach is one big reason why analysts endorse the Alaska Air-Virgin America merger. There’s very little overlap. While this is expressed in terms of anticipated growth, it has real consequences in integration.

Then there’s the issue of a corporate culture, one of the “softer” aspects of post-merger integration. Merging two, often very different cultures can trip up the most methodical integration planning. “It’s very underrated,” said Collins, and often gets swept under the rug, he said. “But it’s a critical component,” in a successful merger, he said.

Once again, airlines can have a more difficult task than others because employees are dispersed geographically. “There isn’t a workforce going into an office every day and creating a culture,” Thomas said.

Already, customers are wondering whether Virgin America’s much-vaunted “coolness” will be a victim of the merger. It may take years to find out.