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Strategic Regionalization of Air Carriers in the Third World

Michael E. Irrgang
Vice President, Operations Planning
Air Jamaica
Kingston, Jamaica

John-Paul Clarke
Assistant Professor of Aeronautics and Astronautics
Massachusetts Institute of Technology
Cambridge, Massachusetts
United States

Air transport plays an important role in the economic development of Third World countries. International air transport contributes to employment and foreign exchange income by transporting business passengers, tourists, and cargo to and from regions of the world that would otherwise be inaccessible or not easily or quickly accessible. In countries with economies that are based on manufacturing and mineral extraction, the availability of air travel enables industry leaders to conduct business with customers and investors throughout the world. In many islands with tourism-based economies, air travel helps the island to compete at long range with other destinations that are much closer to the sources of tourists. Similarly, cargo transport by air permits developing countries to compete in markets—such as fish, fruit, flowers, or other equally valuable (per weight or unit volume) perishables—that would otherwise not be open to them. Thus air transport is an essential part of the infrastructure required for economic development.

For many Third World carriers, economic development is an important motivation for operating an airline. At the same time, carriers from the developed world do not have to consider this objective in their operations. Their primary objective is to maximize profit, and most often airlines achieved this objective by providing enough access for their high-yield business customers from the United States and Europe and their frequent flyer leisure customers, and no more. Thus, in general, the frequencies that are generated by U.S. and European carriers flying to and from Third World countries are not sufficient to spur economic development, and in many cases the business objectives of foreign carriers may run counter to a Third World Country's national development goals and plans. This was the rationale given by Third World countries for the formation of state-run flag carriers. Thus no matter how poorly run or unprofitable these carriers were, they were never allowed to fail. It was, in a sense, a matter of national pride for these nations that they always have an aircraft, especially a 747, visible in London, Paris, or New York flying their country's flag.

National airlines are seldom moneymakers for many reasons, but one of the reasons they find it difficult to achieve profitability is that they are unable to take advantage of the economies of scale that the much larger U.S. and European carriers can achieve. In the United States and Europe, the markets for air services are large enough and concentrated enough that airlines can carve out niches catering to specific business or leisure markets. But surviving in the Third World presents a different challenge. Owning and maintaining a flag carrier is just too expensive for a Third World country unless the planes are doing something more for the country than just carrying the flag. Although these carriers have not been disappearing, many of them have been shrinking to the point that they are little more than a presidential or VIP fleet, a domestic operation, with a few strategic flights to major capitals.

This David and Goliath phenomenon, where the small, Third World flag carriers are pitted against the First World airlines that are currently leading the major global alliances, has become more severe in the last several years as the airline industry has undergone consolidation both through mergers, but more important through the formation of strategic global alliances offering near seamless travel and a great deal of marketing integration. The Star Alliance and **one**world™ alliance together encompass half of the world's top twenty-five airlines, as well as a significant percentage of the next fifty. Probably within a year or two the vast majority of the world's air traffic will be controlled by several alliances, which are themselves dominated by the world's top ten carriers, effectively creating cartels. How, then, can a smaller Third World carrier compete in this environment?

Even in the face of this trend of globalization/ alliances/cartels, it is still possible for a Third World carrier to be viable and prosper. Frequent and dependable air travel is still important to economic development—more so in this age of globalization. A successful Third World airline must follow the same model of capitalism that holds everywhere—that an organization run privately can always be more efficient, dynamic, and successful than a state-run company. At the same time, the government can further the national interest and the interest of the flag carrier by always giving preferential treatment to the flag carrier in regulatory matters and always negotiating bilateral agreements in such a fashion as to favor the flag carrier's interests.

In this chapter we review the approach that has been taken by two Third World airlines, Lan Chile and Air Jamaica, to strengthen their competitive position in the face of the domination of their markets by First World carriers. We refer to this approach as strategic regionalization, that is, the building up of a true regional carrier that responds to the needs of the different countries in the region and builds judicious strategic linkages with external air carriers. Though developed separately by each carrier, the strategic regionalization strategy is remarkably the same for all air carriers.

Background

The Caribbean and South America, given their proximity to the United States, the world's largest economy, are two regions that should be well poised for economic development in the new global economy. In the Caribbean, the primary industries are tourism, agriculture, petroleum, and light assembly. In South America the primary industries are mining, agriculture, forest products, fisheries, tourism, and manufacturing.

Figure 17-1 Lan Chile's Logo.

Figure 17-2 Air Jamaica's Logo.

Although they started quite differently, Lan Chile and Air Jamaica share a lot of history in common. Lan Chile was founded in 1929 as a civil air transport arm of the military. Jamaica was a British colony and was served by Britain's flag carrier until the country gained its independence in 1962. After independence, British Airways, Pan American World Airways (Pan Am) and British West Indies Airlines (BWIA) dominated air traffic. Growing nationalism and a discomfort with relying only on foreign carriers led to the founding of Air Jamaica by the government in 1969. Although there is a great difference in the ages of Lan Chile and Air Jamaica, both began to develop in parallel when each made the transition to a local privately run company in 1994. At that time, each company was taken over by a group of investors led by a strong, aggressive entrepreneur with a clear vision for growth. In the six years since their respective ownership changes, each carrier has grown severalfold. The current revenues of Lan Chile are U.S.$1.2 billion, and those of Air Jamaica are U.S.$360 million per year. To aid in this growth, as well as to educate the carrier in how to deal with the global airline marketplace, each carrier hired a key senior executive from the U.S./European airline world in 1994. These executives are still with the airlines today, having assisted in enabling the airlines' growth. In addition, both carriers are in the midst of major fleet modernizations, which by 2005 or earlier will take Lan Chile to around forty Airbus A-340/A-320 as well as a new Boeing cargo fleet, and Air Jamaica to approximately thirty Airbus A-340/A-320/A-321.

These two carriers reinvented themselves and continue to evolve. Air Jamaica has created a hub in Montego Bay and expanded its network throughout the region. It formed a commuter carrier called Air Jamaica Express, feeding the Montego Bay hub, with flights to as far away as the Turks and Caicos Islands. Air Jamaica has also recently formed a second commuter airline called EC Xpress, providing a service that constitutes the primary means of air travel to and from many small eastern Caribbean islands. Lan Chile has steadily expanded its network throughout the southern half of South America or "Conosur," and provides primary air services in many other countries apart from Chile. The South American airline has recently formed a closely aligned carrier, Lan Peru, has invested heavily in Ecuatoriana, is now forming Lan Dominicana, and will be forming other "Lan..." airlines over the next few years.

LANPERU

Figure 17-3 Lan Peru's Logo.

Air Jamaica has not yet achieved profitability (although it is anticipated in the near term), whereas Lan Chile has been quite profitable for several years. But both airlines have been successful in gaining market share in the countries where they operate and have been instrumental in increasing the growth of air traffic in those markets.

Lan Chile and Air Jamaica have significantly expanded their fleets and their markets and prospered, even while their respective countries have gone through periods of economic decline, and even during major invasions of their regional markets by large U.S. and European carriers. These two airlines have managed to strengthen their competitive position in the face of domination by First World carriers through strategic regionalization, that is, through the building up of a true regional carrier that responds to the needs of the different countries in the region and through the building of judicious strategic linkages with external carriers.

The way in which Lan Chile and Air Jamaica have gone about growing their respective airlines illustrates a common philosophy or approach to growing a regional airline. The tenets of this philosophy are

1. expanding the ethnic market by understanding and catering to its needs
2. attracting nonethnic passengers through positive product differentiation
3. achieving economies of scale through regional capture
4. negotiating and/or exercising favorable traffic and route rights
5. protecting market position through judicious alliances

These tenets are discussed in depth in the following pages.

Expanding the Ethnic Market by Understanding and Catering to Its Needs

Ethnic travelers are key customers for Third World carriers. This is the foundation and fallback position for international flights by any Third World carrier. Thus understanding the travel patterns and travel needs of these customers is an important part of maximizing the airline's market share.

The most obvious travel pattern for the ethnic market is the movement of family and friends to and from foreign countries where there are large communities that have emigrated. For example, there are more Jamaicans or people eligible for Jamaican citizenship in the United States and Canada than in Jamaica. Many of these people live in New York and Miami; thus these designations are obvious markets for Air Jamaica. Great numbers of Jamaicans have emigrated to Great Britain, the former colonial power, creating a natural ethnic air travel market. In the case of Lan Chile, targeting the emigre market means providing service to Spain, the roots of the country's original colonizer. But a secondary ethnic route is a result of the major immigration of Germans to Chile in the late nineteenth century. Accordingly, the only other active European route for Lan Chile is to Frankfurt.

Some destinations are very popular as places for average citizens and traders to go shopping. These destinations constitute another ethnic market. In the case of the Latin American and the Caribbean ethnic market, these markets are primarily Miami and New York. In fact, there is so much traffic to and from Miami that it is often more convenient to find a connection to a South American city via Miami rather than attempting to find a direct flight between two South American cities. Based on seasonal demand, Lan Chile has provided as many as four flights a day between Miami and Santiago, Chile, with convenient stops for Peruvian, Colombian, Ecuadorian, Bolivian, and Venezuelan passengers; and connections priced competitively for Argentinean passengers. Air Jamaica provides a similar number of flights to Miami. At Christmas time, Jamaicans carry so many boxes and pieces of luggage from New York and Miami that Air Jamaica adds more flights just to carry the excess baggage. Panama has recently become another attractive shopping destination for Jamaicans. During the 1980s, there was a significant increase in passenger traffic between Jamaica and Panama, although the Jamaican community in Panama is not as large as that in New York and Miami. This increase in traffic can be attributed to the growth in informal commercial trading—the trading of household goods by average citizens who did not own shops but sold items out of their homes. When Jamaica experienced hard economic times these traders began to trade goods between the two countries because prices were relatively cheap in Panama, as compared to in New York and Miami. Air Jamaica responded by adding flights, enabling passengers on that route to carry very heavy baggage (at a nominal fee) and on some days adding special cargo flights to transport bags and barrels that were too large to be accommodated on the scheduled passenger aircraft.

In any country, First or Third World, there are certain cultural preferences for vacations and tourism. For any flag carrier, recognizing the changes and evolution of such travel, and even guiding its development through marketing programs, is a key element of success. In the case of South Americans, in addition to going shopping in Miami, when they have the time and money for a vacation trip many like to go either to American theme parks or to Caribbean beaches, preferably in Spanish-speaking countries. Accordingly, Lan Chile offers Orlando, Florida, as a vacation destination for theme park traffic. Los Angeles, California, serves as both a vacation destination and a business destination. Punta Cana, Dominican Republic, and Havana are beach destinations. Lan Chile has not been aggressive in adding more beach destinations, which could be an untapped opportunity for the future.

The Jamaican economy is weak enough that overseas vacations to other than ethnic destinations (to visit with relatives) have not developed significantly. The one exception is Orlando, for the same reasons that South American passengers use Lan Chile's service to this destination.

Attracting Nonethnic Passengers Through Positive Product Differentiation

Most of the nonethnic passengers flying to Third World countries travel onboard U.S. or European carriers because of a perception (often false) that Third World carriers are inherently less safe. In addition, tourists often (wrongly) feel that the quality of service is better on First World air carriers.

If the Third World carrier can somehow create a product differentiation that entices the foreign leisure traveler, it can promote the development of tourism in the region. Traffic on the First World carriers is a result of existing demand. The Third World carrier can create demand. In many regions, but especially in islands throughout the world, tourism that relies on air travel has come to dominate the regional economy and enables the islands to compete at long range with tourist destinations that are much closer to the sources of tourists. In the Seychelles, for example, tourism provides 50 percent of the GDP, and accounts for 20 percent of all employment and 70 percent of foreign exchange—but tourism developed only after 1971 with the opening of the international airport. A quick analysis of the passenger flows into the Caribbean illustrates the same phenomenon—and in all, except one Caribbean island, American Airlines provides the most capacity. The exception is Jamaica, where Air Jamaica is the number one carrier in terms of the number of passenger flown into and out of the island. Earlier in the history of Jamaica (before the 1980s) most air traffic was into and out of Kingston. The development of much of the resort business in Jamaica occurred after Air Jamaica began its steady growth in the service provided to Montego Bay. This emphasizes the point that the Third World air carrier can become a strategic national resource through its success and contribution to the economic growth of the country and the region.

To capture traffic, the successful Third World carrier needs to view safety, cost, and on-time reliability as fundamentals. But the airline must also offer some highly visible additional lure to capture foreign traffic. From a yield standpoint, business passenger traffic is the most important sector to attract. Accordingly, a key element of the lure is something that has long been out of vogue in the United States— better-quality service.

Simply put, we are advocating that Third World carriers pursue their own airline version of product differentiation, and pointing out that these carriers can find ways to succeed where larger U.S. airlines fail. All else being equal, passengers will travel on a larger carrier because of the network and schedule it provides and the benefits (status, free travel, perceived safety, and so forth) gained from flying frequently on a single carrier or network of carriers (alliance). For a small Third World air carrier to attract nonethnic passengers, it must offer a perceived positive difference in service quality as compared with the larger First World air carriers. Carriers such as Singapore Airlines, Cathay Pacific Airways, and Malaysian Airlines, for example, have successfully marketed themselves as the embodiment of the best in Asian hospitality, culture, and comfort. This image has been used to attract high-yield foreign passengers who would otherwise travel on larger First World carriers.

The successful Third World carrier must offer greater seat comfort, more and better meals, and other elements of higher quality than their First World counterparts. The Thirld World carrier must then prove the superiority of its offerings by winning awards. Lan Chile and Air Jamaica have been successful in winning the only type of awards that count for foreigners—those from U.S. travel organizations. Lan Chile was the first carrier to offer fully reclining seats in the South American commercial air transport market. Lan Chile's in-flight service features extensive menus of typical Chilean dishes and fine Chilean wines. Air Jamaica's approach to in-flight service has entailed offering an all-inclusive package. The airline serves authentic hot Caribbean meals on all its flights regardless of trip length, and it offers free champagne in all classes of service. At the time of Air Jamaica's privatization and makeover, American Airlines (its major competitor) offered only a light snack in first class and peanuts in economy class. Because Air Jamaica offered full meals, travelers viewed the carrier's service as exceptional, and its business passenger market share grew as a result.

The successful air carrier must also create interest by having a catchy, recognizable, and modern image. Developing positive brand recognition can cost millions of dollars and can have an enormous impact on the success of even First World air carriers. The disastrous image change of British Airways is an example of what is at stake. Both Lan Chile and Air Jamaica have undergone recent image changes specifically designed to give them very catchy and flashy paint jobs, and they have captured awards as well as major recognition and interest. The carrier that still sports the old 1960s image of a plain white aircraft with lettering in the national colors and little more than the name and a logo is doomed not to be noticed.

A Third World airline also needs a slogan or service name to help project its image. Lan Chile carefully selected its slogan to emphasize regional rather than national identity. "The idea was to excite interest among foreigners in traveling "to the ends of the earth." But in Spanish this slogan translates into something that means more like "until the earth is destroyed." So the airline's slogan is "the airline of the south of the world," which in Spanish sounds quite catchy, and refers broadly to all of the Southern Cone countries (in the southern half of South America), where Lan Chile was hoping to become the leader. This strategy has been quite successful, because Argentineans and Peruvians feel a strong regional connection to Lan Chile.

Air Jamaica has focused on attracting the American holiday traveler. The airline's colors are very tropical, evoking rum punch (available onboard). All of the elements of service are associated with the word lovebird, a catchy version of the name of the Jamaican national bird, a type of hummingbird called the doctor bird. Referring to "lovebird" service, of course, evokes numerous double meanings and images suitable for the tourist going for an island vacation.

In order to capture the tourist market from abroad, the Third World carrier needs to work proactively to help build the tourist market. Although fostering tourism is the goal and a likely result of success, planning and initiative are needed nevertheless. Strong links have to be created with government, regional, and local tourism organizations, advertising both the carrier and the countries of the region to U.S. and European travelers.

The major shareholder and the person behind the new Air Jamaica is an entrepreneur named Butch Stewart. He is the founder and owner of the Sandals Resorts, the leading chain of all-inclusive resorts in the Caribbean. He created the modern resort industry in Montego Bay and expanded to other locations later. He has been able to find considerable synergies between the development of his airline and the operation of his hotel chain, by developing tourism as well as air travel markets. His success has spawned imitator hotel chains, many of which are in the same locations, further aiding the growth of Air Jamaica.

Lan Chile has a natural tourist market because of Machu Picchu. The site is already well-known, and Lan Chile has effectively captured many tourists destined for the ancient Incan fortress. Lan Chile also has significant opportunities in the southern Chile ecotourism market, which is still quite small, as well as potential to capture some of Ecuador's Galapagos traffic. After many years substantially ignoring the Ecuador, Lan Chile recently purchased the maximum legal percentage of Ecuatoriana, and is now beginning to run the operations of that airline. This will undoubtedly lead to further exploitation of the Ecuadorian tourist market.

Achieving Economies of Scale Through Regional Capture

Small Third World countries often do not have either the wealth or the middle- and upper-class population to sustain a successful airline. Thus even if an airline were to capture all the passengers going into and out of a specific country, the fixed cost of operating the airline would constitute a disproportionate part of the airline's operating costs and thus reduce profit opportunities. Accordingly, capturing traffic within a region is key to an airline's success.

Lan Chile has been quite successful in taking advantage of the void created when unsuccessful airlines from surrounding countries have been unable to grow strong regional markets. The weakness of Aerolineas Argentinas and Lloyd Aereo Boliviano as well as the failure of Aeroperu created voids that Lan Chile has moved to fill. The only nearby country with strong airlines is Brazil. But the recent deregulation of the Brazilian air transport industry has seriously damaged VASP, effectively leaving only TAM and Varig. Lan Chile, a member of oneWorld, has managed to forge relationships with both TAM and Varig, engaging in cooperative purchase contracts and code sharing with TAM, and engaging in a code-share agreement with Varig even though Varig is part of the rival Star Alliance. Since there are no strong airlines in the northern part of the continent except for ACES, Lan Chile has also been able to capture a significant portion of the traffic from northern South America to the United States.

Air Jamaica's regional growth strategy has been very similar to that of Lan Chile. The Jamaican airline has focused on serving countries in the eastern Caribbean that have significant tourism industries and that do not have national carriers and/or are poorly served by existing carriers. Islands such as St. Lucia, Grenada, Trinidad, and Barbados are now served directly or with one-stop service from New York. Air Jamaica consolidates traffic to other islands in St. Lucia and Barbados. In addition. Air Jamaica recently announced the formation of EC Xpress, a regional subsidiary that feeds passengers from islands and countries served by one-stop international flights to islands not served by such service, such as Dominica and St. Vincent. Thus Air Jamaica now offers direct or connecting service to most of the islands in the Caribbean, a significant change from only five years ago, when the airline offered service only in the northern Caribbean, that is, to islands near Jamaica such as the Bahamas and Grand Cayman.

Figure 17-4 EC Xpress's Logo.

The most critical element of Air Jamaica's success recently, and the element that is going to carry it forward into profitability, is the development of a hub in Montego Bay over the last two years. The Montego Bay hub has created considerable traffic beyond Jamaica for Air Jamaica. It has also made possible the availability of various new U.S. destinations, which are being added at the rate of about one every three or four months.

Negotiating and/or Exercising Favorable Traffic and Route Rights

The greatest barrier to the expansion and growth for a Third World air carrier is the very framework within which the international air transport industry functions. Specifically, the bilateral framework, conceived in Chicago in 1944, still poses monumental barriers to the achievement of a liberalized air transport system, and it often presents insurmountable hurdles for most Third World air carriers in particular. The exchange of commercial air services rights (freedoms) is negotiated by an air carrier's government. The air carrier, therefore, is dependent on its government's success in negotiating a bilateral agreement that gives the air carrier the specific commercial freedoms that it needs to survive and prosper. At the culmination of numerous air services negotiations, one of the parties often walks away with more than the other; and, sometimes, the agenda that drives and shapes a government's negotiating posture is not the same nor is it even congruent with that of the air carrier. The inability of a Third World air carrier to gain adequate traffic rights can constitute a barrier so high that the carrier may be unable to even "get into the game." Once the carrier is in the game, those same barriers may mark the Third World air carrier's demise.

In Third World countries, trade protectionism has been prevalent in every sector of the economy. With regard to aviation "trade" (the bilateral exchange of air service freedoms or rights) varying degrees of protectionism are still prevalent throughout the world. The geographically smaller countries frequently place severe restrictions on the awarding of fifth freedom rights or may not grant such rights at all. Fifth freedom rights allow an airline from a foreign country (country A) to land in country B, dropping passengers and cargo, and then, after picking up passengers and/or cargo in country B, the airline is permitted to continue on to a third country, country C. These rights are often referred to as *beyond rights*. The United States' negotiating posture generally restricts a foreign air carrier's fifth freedom rights.

Another of the freedoms defined at Chicago is the right of cabotage. Cabotage is the right that permits an airline registered in country A to land in country B, in city Bl, drop passengers and cargo, and then pick up passengers and/or cargo in city Bl, to fly them to another city in country B, for example, city B2. In essence then, cabotage rights permit the foreign airline, registered in country A, to participate and compete in country B's domestic market. Cabotage is generally prohibited by the United States and severely restricted by numerous countries throughout the world.

Although the only country that places absolutely no restriction on air traffic rights is Singapore, Chile is a country that employs a very liberal approach to air traffic rights. Under Chilean law since the Pinochet regime, Chile will automatically allow any country the same degree of air traffic freedom that that country is willing to reciprocate with Chile. The goal of all bilateral negotiations by the Chilean government is to gain the greatest degree of freedom possible.

Lan Chile's natural expansion into the region would logically imply applying all of the same successful route concepts that have allowed the airline to grow so well to each of the other countries in the region. In other words, good flights to Miami, New York, Madrid, other ethnic destinations (each country in the region has a secondary ethnic destination: for Argentina it is Rome; for Brazil, Lisbon; for Peru, Japan; and so forth), and to the Caribbean.

The logical approach is to form a hub. But Chile's geographic location is wrong. In South America, Sao Paolo or Lima could be good hubs, but few other major cities have the location or the population. The approach that Lan Chile tried as an alternative was to negotiate fifth freedom rights to enable growth. But nationalism, pride in local flag carriers, and protectionism all effectively stymied most such negotiations.

So instead Lan Chile has hit on a winning formula for the future: in any regional country of interest, find a local partner to form a new airline in partnership with Lan Chile, to the maximum degree of ownership permitted by the local government. The new airline carries the same image and operates as identically as possible with Lan Chile, except, of course, it relies on local crews and regulations. The first of these carriers added to the Lan Chile family was Lan Peru. Unfortunately, Lan Chile encountered a stiffer local competitive market than it had anticipated in Peru. There also was a major falling out due to disagreements on financial terms with its Peruvian partner. In early 2001, Lan Peru had temporarily or possibly permanently ceased operations.

The idea in the future is that there will be a series of other "Lan..." airlines, developed country by country through the region. The next step, which has been in the planning stages for a year or so, and has been mentioned in the press, will be Lan Argentina. Undoubtedly we will see more such ventures over the next decade if Lan is able to continue its successful growth. For the carriers such as Lan Peru, Ecuatoriana, and the other "Lan..." carriers, a key part of the plan for future success, as well as for the success of Lan Chile, will be tied to defining and building a major hub operation somewhere north of Chile. This had also been part of the plan for Lan Peru, but was temporarily put on hold when Lan Peru ceased operations in late 2000. Lan Peru remained grounded for nearly three months, but has recently announced a renewal of both domestic and international flights during the first quarter of 2001.

Figure 17-5 Air Jamaica's Newest Livery, Emphasizing the National Flag. This Picture Was Shot as the Aircraft Left the Hanger after Painting.

In the case of Air Jamaica, the airline and the country suffered greatly several years ago when pursuant to the Federal Aviation Administration's (FAA's) policy and the implementation of the International Aviation Safety Assessment (IASA) program, the United States downgraded Jamaica's air regulatory rating to Category 2. In 1998 the FAA implemented a policy whereby it "rates" foreign governments' civil aviation authorities with respect to the authority's ability to exercise adequate oversight of the country's airline industry to guarantee minimum safety oversight standards as established by the International Civil Aviation Organization (ICAO). The Category 2 rating of the Jamaican Civil Aviation Authority meant that the authority had been judged as having insufficient air safety oversight, and accordingly severe restrictions were unposed on Air Jamaica's access to new destinations in the United States. The restriction was later lifted. Since then Air Jamaica has worked closely with the government to ensure continued access to new markets as the airline has been prepared to service them. Future expansion will be oriented toward serving new markets where there is a core demand for Montego Bay or Kingston, but where there are also beyond capabilities via the Montego Bay hub.

Figure 17-6 More "Lan—" Airlines Are on the Way.

An airline is a very important national asset for a Third World country. It brings hard currency into the country, and, as indicated previously, it is likely to generate new business, not just displace business from foreign carriers. Accordingly, the regulatory authorities of Third World countries should recognize the need for and the airline should work toward implementing a close cooperative arrangement. Obviously the two should work together in traffic rights negotiations. But the partnership should also be put to work on labor regulations for pilots and flight attendants, airport development, and air traffic control issues. In regulatory issues, key points where the government should support the business needs of the airline are those relating to the implementation of new technology in air traffic control, the definition of domestic routes and regulations, training issues, and the country's inputs to international regulatory bodies such as the ICAO and industry trade associations such as the International Air Transport Association (IATA).

Lan Chile maintains a very close relationship with the Chilean aviation regulatory body (DGAC), the Ministry of Public Works (MOP), that is, for airport projects, the Ministry of Labor, and with the president's office and the foreign ministry whenever bilateral agreements are being discussed. As a result, the country has been coordinating the development of its aviation infrastructure with Lan Chile.

Traffic and route rights are also a key component of Air Jamaica's expansion in the Caribbean. In fact. Air Jamaica has been granted flag carrier status and fifth freedom rights by other Caribbean islands. These concessions have enabled the airline to utilize the traffic and route rights of these countries and, as with Lan Chile, allowed Air Jamaica to create a mini-hub in Barbados to distribute and consolidate passengers on flights to the eastern Caribbean from New York and Montego Bay.

Protecting Market Position Through Judicious Alliances

The primary threat to the Third World air carrier is that as soon as the First World air carriers see signs of increasing demand, they descend like vultures to ravage the market. If the local carrier tries to compete head-to-head, it is doomed to failure—in spite of various national laws, the protection Third World countries can offer to fight unfair competitive practices by the giants is not the same as in the United States. The only hope for survival and success is for the small carrier to seek an alliance with one of the giants. Once in an alliance, the most important tool for the Third World air carrier is that passengers can acquire frequent flyer miles in one of the major mileage programs while flying on the Third World carrier.

In the case of Lan Chile, it became clear to U.S. carriers in 1998 that Chile was a high demand destination, Lan Chile was threatened by American Airlines, United Airlines, and Continental Airlines, all simultaneously. Of the three airlines, American Airlines was clearly the strongest in the marketplace; it also appeared to be the strongest worldwide. American Airlines was also the carrier with the clearest and strongest Latin American strategy. Therefore it was the logical "enemy." Continental Airlines was not yet in the market, and unfortunately for all the participants, Continental's mode of rapid entry was to "trash" the fares from the United States to Chile: Continental would lower the cheapest fares by nearly 40 percent not on a short-term basis but on a permanent basis. This move hurt Lan Chile significantly, and it also made the route less profitable for other carriers. After two years. Continental Airlines has veritably pulled out of Chile, no longer offering even a nonstop flight. In the meantime, seeking a strong alliance was the only way for Lan to survive. The logical "enemy" was also now the only rational choice for an ally. Lan entered into a code-share agreement with American Airlines and ultimately also became a member of **one**world™. This proved to be a very successful arrangement for Lan. Instead of losing more traffic to American Airlines, Lan Chile gained a lot of connection traffic, as well as passengers who preferred Lan's better-quality service.

Air Jamaica has taken a different approach to alliances. Instead of joining with its largest competitor as Lan Chile did. Air Jamaica decided to compete with American Airlines on key routes and enter into marketing and code-sharing arrangements with American Airlines' competitors. This strategy has enabled Air Jamaica to broaden its reach into the wider U.S. market. Air Jamaica and Delta Air Lines have had a marketing agreement for many years, and in recent years they have expanded their arrangement into a code-sharing arrangement. Thus a passenger in Boston who wishes to fly to Jamaica can fly to either Atlanta or New York's John F. Kennedy International Airport (JFK) on Delta Air Lines and then fly on a Delta Air Lines code-share flight (operated by Air Jamaica) to Montego Bay or Kingston. Likewise, a passenger wishing to fly to St. Lucia or Barbados can fly to JFK on Delta Air Lines and then on to these destinations on Air Jamaica. The Air Jamaica option is very good compared to the propeller service over San Juan and limited service out of Miami on offer from American Airlines. In the eastern Caribbean, Air Jamaica has recently announced a code-share/ alliance relationship with Virgin Atlantic Airways that will feed passengers to its new regional subsidiary, EC Xpress. The obvious benefit to Virgin Atlantic Airways is that the airline can offer passengers more—as well as providing passengers with the option of flying to the Caribbean and to the United States on a single alliance.

Summary

Air transport plays an important role in the economic development of Third World countries. For many Third World air carriers, the goal of economic development is an important component of the airline's reason for being. It was the rationale given by Third World countries for the formation of state-run flag carriers. National airlines are seldom profitable for many reasons, but one of the reasons they find it difficult to achieve profitability is that they are unable to take advantage of the economies of scale that the much larger major U.S. and European carriers can achieve. This phenomenon has become more severe in the last several years and continues today, as the airline industry undergoes consolidation both through mergers, but more important through the formation of strategic global alliances offering near seamless travel and a great deal of marketing integration. Even in the face of this trend of globalization / alliances / cartels, it is still possible for a Third World air carrier to be viable and prosper.

Lan Chile and Air Jamaica are two airlines that have significantly expanded their fleets and their markets and prospered, even while their respective countries have been through periods of economic decline and even during major invasions of their regional markets by large U.S. and European carriers. The way these carriers have gone about growing their business illustrates a common philosophy or approach to growing a regional airline. The tenets of this philosophy are

1. expanding ethnic market by understanding and catering to its needs
2. attracting nonethnic passengers through positive product differentiation
3. achieving economies of scale through regional capture
4. negotiating and/or exercising favorable traffic and route rights
5. protecting market position through judicious alliances

Third World carriers need to recognize that the airline business is very complex and requires a lot of special training, expertise, experience, and tools, all of which are becoming more and more complex every year. Effective maintenance is critical. Reservation and distribution systems, yield management, operations systems, and so forth—all of these need to be made world-class if the airline is to be world-class.

In the past three years both Lan Chile and Air Jamaica have been pursuing programs to acquire new, state-of-the-art systems for reservations, distribution, scheduling, yield management, operations control, crew planning, and maintenance management. They have also brought in experts from other airlines on expatriate contracts for several-year stints.

The Third World airline needs to "think global" on its path to success.