

***Swissair's* Collapse – An Economic Analysis**

Andreas Knorr and Andreas Arndt

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Abstract

Swissair's rapid decline from one of the industries' most renowned carriers into bankruptcy was the inevitable consequence of an ill-conceived alliance strategy – which also diluted *Swissair's* reputation as a high-quality carrier – and the company's inability to coordinate effectively its own operations with those of *Crossair*, its regional subsidiary. However, we hold that while yearlong mismanagement was indeed the driving force behind *Swissair's* demise, exogenous factors both helped and compounded it. These include, in our view, first and foremost, the Swiss people's rejection of the European Economic Area (EEA) Treaty in a 1992 referendum, Switzerland's protectionist aviation policy, and media failure.

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Swissair's Collapse – An Economic Analysis

Andreas Knorr and Andreas Arndt*

Introduction

On October 2nd, 2001, the entire *Swissair* fleet was grounded due to the insolvency of its parent company, the *SAirGroup*¹. Two days the latter it plus some of its subsidiaries (most notably *SAirlines* and *Flightlease*) were forced into Chapter 11-like “Nachlassstundung” to seek protection from their creditors. Around one month later, on November 7th, Belgium’s *Sabena*, in which the *SAirGroup* had held a 49.5 per cent stake since 1995, had to declare bankruptcy, too. With the aim to prevent a permanent grounding of the airline with the resulting loss of valuable slots and gates both at *Swissair*’s Zurich hub and at all its former destinations, to provide for a smooth and orderly reallocation of as many jobs and assets as possible to a new national carrier and to keep vital air links to and from Switzerland largely intact, the Swiss Government almost immediately granted an emergency bridge loan of initially Sfr. 450 mio. (\approx € 292 mio.); with the restructuring process dragging on longer than expected it had to be topped up by an additional Sfr. 1.6 bn. (\approx € 1.0 bn.) only a few weeks later. In sum, Switzerland’s Federal Government, the Cantonal governments, and private investors including the countries two largest banks UBS and Credit Suisse and most major Swiss companies spent Sfr. 4.25 bn. (\approx € 2.75 bn.) to replace the defunct *SAirGroup* with *SWISS*, the new national airline – i.e. Sfr. 600 (\approx € 388) per inhabitant (or Sfr. 375 per head if only public funds are counted)!² The latter was built up around the *Crossair* nucleus, then Europe’s largest regional airline and one of the *SAirGroup*’s few remaining commercially viable subsidiaries and began operations on March 31st, 2002. The *Swissair* collapse is unique not only because the airline was the first European flag carrier ever to fold.³ More important still, although the company’s woes became increasingly obvious, the speed of its demise was astounding. For decades, until the early 1990ies, it had consistently boasted one of the industry’s strongest balance sheets, earning the company the nick-name “flying bank”. Immediately before its collapse, however, *SAirGroup*’s equity had been almost completely wiped out (equity ratio on August 31st, 2001: 2.55 per cent!).⁴ What is more, in the last full fiscal year of its existence,

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¹ In this text, for simplicity we will use *Swissair* and *SAirGroup* – officially created as a holding company on January 1st, 1995 – synonymously.

² By comparison, the US government’s support for airlines after 9/11 amounted to a paltry \$18 (\approx Sfr. 30) per head.

³ *Swissair*’s and *Sabena*’s bankruptcies respectively were their countries biggest ever.

⁴ See *Ernst & Young* (2002).

ending December 31st, 2000, it had not only accumulated liabilities of Sfr. 18.86 bn. (≈ € 12.25 bn.), up from Sfr. 13.46 bn. (≈ € 8.75 bn.) the year before. *SAirGroup* also had to post negative earnings before interest and taxes (EBIT) to the order of Sfr. 2.59 bn. (≈ € 1.68 bn.).⁵ Widely, but wrongly, associated with the events of September 11th, we will argue in this paper, that the company's fate was almost inevitably the consequence of incredible incompetence at both the top management and supervisory board levels as regards the group's alliance strategy and internal coordination failures – seriously compounded, however, by a number of factors outside *Swissair*'s control.

Swissair/SAirGroup – A Company Profile

Schweizerische Luftverkehrs AG – or rather *Swissair* as the company would be known later – was established on March 26, 1931, with the merger of Zurich-based *Ad Astra Aero AG* and *Basler Luftverkehr (Balair)*.⁶ From its very beginnings the company successfully pursued a high-quality strategy stressing safety, passenger comfort, reliability and punctuality, winning it many “Best airline”-awards in all decades to come. For example, the company became, in 1932, the first European airline to introduce Lockheed Orion high-speed aircraft to its fleet which reached a cruising speed almost twice as fast as that of existing passenger planes. Later, it would regularly be amongst the launching customers for many important aircraft programs including the B747-300, the A310, the MD-80 and the MD-11. Another premiere, for Europe at least, was the company's 1934 decision to employ air hostesses on its passenger flights. After World War II, *Swissair*'s rapid growth helped it become one of the world's major international airlines both in terms of passengers carried and available passenger miles (table 1). From the 1960ies until its demise in 2001 it had managed to establish itself firmly around rank 20. The quality focus, compounded by the general lack of competition in the airline industry, came at a price, however: overmanning, with personnel costs reaching 39 % of the company's total operating costs, one of the highest percentages in the industry, and an ever-rising break-even load factor as a result.

Table 1: Swissair/SAirGroup's Growth 1931-2000 at a Glance

	1931	1946	1970	2000
Size of fleet	13	16	35	161
Number of employees (full-time equivalent)	64	789	13,280	71,900
Number of revenue passengers	10,282	62,378	3.9 mio	19.2 mio
Number of cities served	20	15	75	218
Break-even load factor	n/a	n/a	49 %	75 %

Source: von Schroeder (2002: 17).

⁵ See *SAirGroup* (2001: 9).

⁶ For details see Gratenau (2002: 4ff.); von Schroeder (2002). – *Ad Astra Aero* was one of three Swiss airlines founded in 1919. Due to economic difficulties it took over its two competitors – *Aero-Gesellschaft Compte-Mittelholzer & Co.* and *Avion Tourisme* – in February 1920. *Balair* was established in 1925. It was the first of three Swiss airlines bearing this name until today.

Throughout the entire post-war period until around the early to mid-1990ies, *Swissair's* attitude with regard to financial management can only be described as extremely risk-averse – resulting in one of the industry's strongest balance sheets and an excellent credit rating. Behind this were, first, at 1.2 : 1, a very demanding internal ceiling for the maximum acceptable debt-to-equity ratio. Much more often than not, the actual figure was even better, and only in one fiscal year, *Swissair* came close to this limit. Second, a very conservative depreciation policy permitted the company to generate both a healthy cash flow and substantial hidden reserves.⁷

The traditionally prudent fiscal stance was abandoned in the mid-1990ies, however, when *Swissair* – or rather the *SAirGroup* as it had been renamed by then – embarked upon an ambitious equity-based alliance and acquisition strategy. Equally focused upon both airline partnerships and non-airline activities it had been considered indispensable by the company's top management and its supervisory board to establish *Swissair* firmly as the no. 3 or no. 4 player in an increasingly deregulated European aviation market to which the carrier had only limited access after Switzerland's surprising 1992 veto to join the European Economic Area (EEA). *Swissair* has long since been painfully aware of the limited growth potential of its homemarket – the country's population is only 7 million –, which due to high labor costs and the country's strong currency is also one of the most expensive business locations in the world –, and the very cyclical nature of the airline industry.

As a result, it was one of the first carriers in Europe and the world to expand into ancillary and non-aviation activities – including but not confined to maintenance and repair, ground handling, IT, aircraft leasing, catering, duty free, hotels, aerial photography, and even agriculture, all of which by 2001 accounted for more than half of *SAir-Group's* employees and most of its profits. Moreover, *Swissair* was also one of the very first airlines to seek close ties with other carriers. Dating back to the late 1960ies, *Swissair's* first alliance was the KSSU group (with *KLM*, *SAS* and *UTA*)⁸ for the joint maintenance of widebody aircraft which were being introduced at that time. As early as 1989, it began forging alliances in its core passenger business, too: the *European Quality Alliance* (*Sabena*, *Austrian Airlines*, *SAS* and *Finnair*), *Atlantic Excellence* (*Delta*, later complemented by *Austrian Airlines* and *Sabena*) and *Global Excellence* (*Delta* and *Singapore Airlines*). Two events, however, prompted *Swissair* to fundamentally rethink its alliance strategy:

- The failure of the visionary *Alcazar* project, a proposed wide-ranging tie-up of four small and medium-sized carriers (*Swissair*, *KLM*, *SAS* and *Austrian Airlines* with a full-blown merger as the final objective so as to create a counterweight to the “Big Three” Lufthansa, Air France and British Airways which were then – and still are – dominating the European airline industry; and
- the defection of many of its most important airlines partners to competing alliances from the mid-1990ies.

⁷ See von Schroeder (2002: 214).

⁸ As early as 1950, *Swissair*, *KLM* and *Sabena* had created a joint spare parts pool in the so-called *BeNeSwiss* Agreement. In 1958 *Swissair* and *SAS* had crafted a cooperative agreement to standardize their fleets around a number of jet types and to pool maintenance and training resource. See Wegg (2002: 17)

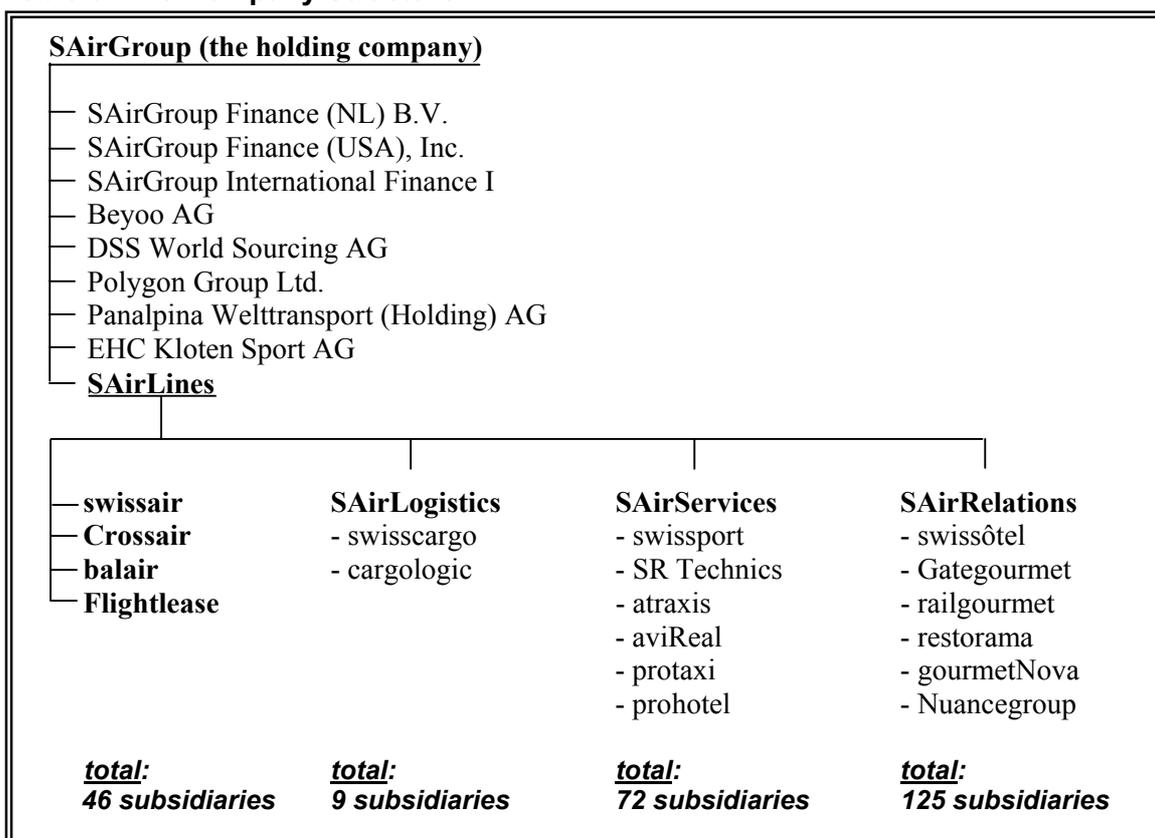
Instead of joining one of the major alliances, too – an option that both management and supervisory board never seriously considered –, the company decided to create two *Swissair*-led and equity-based alliances: *Qualifyer* (with smaller non-aligned European flag carriers as its members) and the *European Leisure Group* (in the charter market). For reasons we will discuss in more details in the chapters below, this two-pronged approach aimed at diversifying risk and securing its long-term growth was of the key factors behind the company's insolvency, however. This is because, while being commercially sensible in principle for a carrier as small as *Swissair*, its version was both badly conceived and implemented. The following tables 2-4 provide a general overview of the *SAirGroup's* commercial activities – an extremely complex web of 260 companies (including all minority shareholdings) – and of the (increasingly precarious) state of its finances by the end of FY 2000, its last full year in business before the grounding.

Table 2: Five Year Review (in million CHF)

	1996	1997	1998	1999	2000
Total operating revenue	8,212	10,556	11,297	13,002	16,229
Earnings before interest and taxes (EBIT)	344	658	700	643	(2,592)
Net profit/(loss) for the year	(497)	324	361	273	(2,885)
Liabilities and shareholders' equity					
Liabilities*	9,708	10,191	11,181	13,673	19,055
Shareholders' equity	2,109	2,439	3,549	4,181	1,160
Personnel (full-time positions)	36,050	39,967	43,696	68,442	71,905
*including current liabilities, non-current liabilities, provisions and minority interests.					

Source: *SAirGroup (the holding company)* (2001: 42).

Table 3: The Company Structure



Source: SAirGroup (the holding company) (2001: 34ff.).

Table 4: Breakdown of EBIT by business unit (in million CHF)

	1997	1998	1999	2000	2001-1H
EBIT by division					
SAirLines	264	354	188	35	138
SAirServices	127	145	165	162	(6)
SAirLogistics	43	33	6	99	17
SAirRelations	181	153	269	300	56
SAirGroup	43	15	95	68	(111)
SAirLines investments			(80)	(3,256)	(137)
Total EBIT	658	700	643	(2,592)	(43)

Source: Suen (2002: 361).

Economic Analysis

Principal Causes

A Failed Alliance Strategy

A Chronology of Events

In 1989, *Swissair* became the first European airline to seal a partnership agreement with an overseas carrier: *Delta*. Part of the arrangement was a mutual 5 per cent equity swap. One year later, a similar deal with *Singapore Airlines*, which in turn was already cooperating with *Delta*, followed. An arrangement with *Swissair's* first choice – *Thai Airways* – failed to materialize because of objections held by the Thai government. Given the fact, that Bangkok was by far the most important Southeast Asian airport in *Swissair's* network, handling almost 80 per cent of the company's local traffic, strategically *Thai Airways* would have been a much better fit, however, as well as a more reliable partner than *Singapore Airlines*.⁹ Also in 1989, *Swissair* signed an important partnership agreement with *SAS* – which ironically at that time was cooperating with *Thai Airways* in Asia (and *Continental* in the USA) –, giving it better access to the vital EU market. In 1990, *Austrian Airlines* and *Finnair* joined in, and the group was named *European Quality Alliance (EQA)*.

On December 6th, 1992,¹⁰ rather unexpectedly, 50.3 per cent of the Swiss population voted against the ratification of the European Economic Area (EEA) Treaty. *Swissair* was particularly hard hit by the veto. Instead of being granted 3rd and 4th freedom rights into the EU with immediate effect, 5th and 6th freedom rights two years later and the option to open 8th freedom rights negotiations five years later, as well as the abolition of some ownership restrictions, Switzerland was now forced to renegotiate its existing – and rather restrictive – bilateral air service agreements with every single EU member-state.¹¹ Equal access for Switzerland-based airlines to the EU market was granted only in combination with a wider bilateral deal between the EU and Switzerland – the so-called *Personenverkehrsabkommen* (passenger transport agreement). It was ratified by Switzerland on May 21st, 2000, and entered into force on June 1st, 2002 (with some transitional provisions in force until June 1st, 2004).¹²

Swissair's first reaction to the veto was to push ahead with the *Alcazar* project: Acronym for “Alone carriers zigzag at random”, secret talks had begun in fall 1992 between *Swissair*, *SAS*, *Austrian* and *KLM* to form an unprecedented alliance. Starting with joint management structures and ever increasing cooperation, a full-blown merger was fixed as the ultimate objective as soon as it would be legally feasible. On November 21st, 1993, however, *Alcazar* was abandoned due to unfavorable media coverage, political

⁹ See Moser (2001: 61f.).

¹⁰ For a more comprehensive survey of events see *Manager Magazin* (2002).

¹¹ See Saxer (1999).

¹² See Saxer (1999).

pressure and insurmountable differences with regard to ownership and control as well as organizational issues. The choice of the future US partner airline proved to be a particular bone of contention. *Swissair's* insisted on *Delta* and refused to accept *Northwest – KLM's* favourite –, although the latter's share of the transatlantic market substantially exceeded the former's.

Immediately after the breakdown of the talks *Swissair* began to seek a substitute partner which it found in Belgium. Hence, on December 14th, 1994, *Swissair's* supervisory board gave the green light for the acquisition of a 49.5 per cent stake in Belgium's flag carrier *Sabena*. In late 1997, the board accepted the so-called "Hunter strategy".¹³ Developed by *McKinsey*, a consultancy, it meant a *Swissair*-led equity-based alliance to establish, with a 20 per cent market share in Europe as the stated objective, the company firmly as one of the key players on the European market. Implementation began in March 1998 when the *Qualifyer Group* was created. Moreover, between June 1998 and November 1999, *Swissair* spent Sfr 4.1 bn (\approx € 2.65 bn.) to purchase significant shareholdings in a variety of other airlines – flag carriers as well as charter operators and even one freight operator –, the most important of which are displayed in table 5 below. Finally, substantial investment took place in aviation-related activities (as illustrated by the takeover of *Dobbs*, a US-based caterer).

Table 5: *Swissair's* equity stakes (%) in other airlines as of 2000

Air Europe	49.0	Volare Air	34.0
Air Littoral	49.0	Austrian Airlines	10.0
AOM France	49.5	Balair/CTA Leisure	100.0
Crossair	70.5	Cargolux	33.7
LOT Polish	37.6	LTU Group	49.9
Portugalia	42.0	South African Airways	20.0
Sabena	49.5 ^a	Ukraine International Airlines	5.6
TAP Air Portugal	34.0 ^b		

Source: Own statement of facts based on *SAirGroup* (2001) and *SAirGroup (the holding company)* (2001).

^a*Binding commitment to increase share to 85%.*

^b*Comittment, but transaction had not taken place yet.*

On September 21st, 2000, *Swissair's* supervisory board nodded off the management's proposal to take over at least 50 per cent of *Alitalia* (code name: "Vodka"-project). The plan was aborted only a few months later, when the board had to declare the failure of the "Hunter strategy" and discussed exit scenarios for *Swissair's* mostly loss-making investments in the above-mentioned airlines. CEO *Philippe Bruggisser* was ousted on January 20th, 2001. On January 25th, 2001, however, *SAirGroup* and the Belgian government still agreed on the former to increase its share in *Sabena* to 85 per cent,

¹³ For details see *Chang/Williams* (2002: 134).

although it already was effectively controlled before¹⁴ – with both sides ignoring the fact that they were in clear breach of European laws which prohibits non-EU-based investors to acquire more than a 49.5 per cent share in any EU-based airline. Amazingly, the *SAirGroup* committed itself to fully compensate the Belgian government for any damages that the latter might suffer if, for whatever reason, it would withdraw from the deal.¹⁵ Finally, on April 2nd, 2001, *SAirGroup's* new Chairman of the Board, *Mario Corti*, announced a loss of Sfr. 2.885 bn. (\approx € 1.86 bn.) for FY 2000. Most of it was due to the full consolidation of actual and imminent losses from the group's interests in other airlines (before *Corti* no such consolidation had been performed).

Evaluation

As regards *Swissair's Qualiflyer* alliance *Suen*¹⁶ concludes in her analysis that while “strategy was sound” the “Swissair Group's bankruptcy is the result of failures in implementing [it].” In particular she argues that, from a resource-based view, *Swissair* did not need the large equity investments it committed to in order to prevent its partners from defecting because “the relationships were asymmetrical in *Swissair's* favor.” This point is valid insofar as all of *Swissair's* earlier alliances – *EQA*, *Atlantic Excellence* and *Global Excellence* – had indeed collapsed because of the defections of key members to competing groupings: Most notably, between 1996 and 2000 *Singapore Airlines*, *Austrian* and *SAS* had all opted for the *Star Alliance*, in 1995 *Finnair* left for *Oneworld*, and, finally, in 2000 *Delta* decided to create its own alliance, *Skyteam*, with *Air France* instead of much smaller *Swissair* as its preferred European partner¹⁷ (*Swissair* was invited to join in but declined the offer for fear of being scaled down to become a mere regional partner).

While *Swissair's* equity-based approach to alliances may indeed be interpreted as an attempt to stabilize *Qualiflyer*, on this point we rather agree with the *The Economist's*¹⁸ judgment that the true motivation behind it was to buy “customers for the aviation-service business it was also acquiring.” Indeed, *Qualiflyer* was unique amongst alliances insofar as one airline – *Swissair* – in all respects (reputation, brand, financial clout, fleet size, RPK, infrastructure etc.) clearly was the dominant force. What is more, *Qualiflyer* was not organized as the web of bilateral arrangements amongst members on top of some common mutual commitments which is typical of all other alliances. By contrast,

¹⁴ There is a large body of evidence proving this claim. First of all, almost immediately after *Swissair* had acquired 49.5 percent of *Sabena's* equity, former *Swissair* executives were brought in to become CEO. In addition, the *SAirGroup* decided to contract out the responsibility for both carriers' flight operations to a joint London-based subsidiary called Airline Management Partnership (AMP). Finally the *SAirGroup*, a major Airbus operator, induced *Sabena* to switch from Boeing to Airbus for a massive order of new jet aircraft (see *Gumbel* (2002); *Avonds/Bossier/Gilot/Van den Cruyce/Vanhorebeek* (2002)).

¹⁵ Similar financial commitments were made almost every time the *SAirGroup* acquired a share in another flag carrier.

¹⁶ See *Suen* (2002: 355 and 363).

¹⁷ Given the much bigger size of the French market, *Air France's* status as a EU-carrier – with full access to the EU- and EEA-market, and the significant capacity reserves at Paris Charles de Gaulle-Airport, *Delta's* decision was perfectly rational.

¹⁸ See *The Economist* (2001).

Qualifyer was organized as a hub-and-spoke-system with almost all members supposed, or even obliged to contract out many of their aviation-related services (ground-handling, maintenance, IT) to a *SAirGroup* company or to lease their aircraft from *Flightlease*, another subsidiary (sale-and-lease-back arrangements were also common). While on the one hand increasing the group's share of the market for ancillary services – with *SAirGroup* companies being granted preferred or even exclusive supplier status –, this approach on the other hand not only dramatically raised the costs of the exit option. Moreover, as a result, *Swissair* was also forced to keep many of its financially struggling partners afloat by means of huge capital injections – both to keep *Qualifyer* viable and to protect its aviation-related businesses.

As originally devised by *McKinsey*, the “Hunter strategy” exclusively targeted smaller European countries and markets with huge growth potential such as Belgium, Austria, Finland, Hungary, Poland, Portugal and Ireland only. *Swissair* was not supposed to acquire more than 10-30 per cent of its partners' equity, and a maximum of Sfr. 300 mio. (≈ \$ 194 mio.) should be spent.¹⁹ Traffic from these markets should then be funneled through Zurich and Brussels airports to establish *Swissair's* and *Sabena's*, and hence *Qualifyer's*, principal hubs amongst Europe's key gateways – especially to the benefit of *Swissair's* intercontinental partners *Delta* and *Singapore Airlines*.²⁰ In practice, however, the acquisition strategy not only centered around the mature major EU markets Italy, Germany and France and cost Sfr. 4.1 bn (≈ € 2.65 bn.) to implement. Even worse, *Swissair* was willing to accept in almost all cases (near-)full responsibility for its partners' financial obligations. What is more, due to lacking synergies, the “Hunter strategy” never supported an expansion into the volatile and low-margin charter market.

Contrary to *Suen*, we also hold that *Swissair's Qualifyer* alliance – and hence the “Hunter strategy” – was not just badly implemented. It was also fundamentally flawed in the following two key respects:

- Through *Qualifyer*, *Swissair's* management diluted the company's valuable brand by predominantly selecting second- and third-rate carriers as alliance partners – effectively only carriers that had been shunned by the other alliances –, the majority of whom had also suffered substantial losses for an extended period of time (table 6 below). *Sabena*, for example had managed to post a profit only twice throughout its 78-year history: in 1958 (because of the *Expo* taking place in Brussels in that year) and in 1999 (due to some window-dressing by means of a sales-and-lease-back deal with *Flightlease*).²¹
- Not just tarnishing *Swissair's* well-established image as a high-quality operator, *Qualifyer* therefore also increasingly undermined the carrier's ability to extract premium fares from its passengers. Last not least, *Swissair's* increasing dependence on much less profitable transfer traffic – around 30-40 per cent of

¹⁹ See *Ernst & Young* (2002).

²⁰ Amazingly, *Swissair's* management seems to have completely overlooked the fierce hub competition *Sabena* faced in Brussels – with London (BA), Frankfurt (LH), Paris (AF) and Amsterdam (KL) only forty flight minutes away – when it decided to invest in *Sabena*.

²¹ See *Enz* (2001), *Moser* (2001: 80f.). – For an official evaluation of the effects of *Sabena's* bankruptcy for the Belgian economy see *Avonds/Bossier/Gilot/Van den Cruyce/Vanhorebeek* (2002).

all passengers – put significant downward pressure on fares, yields, and financial results.

Finally, in our view management hubris was a major factor in explaining both the failure of *Swissair's* earlier European alliances, including the abandoned *Alcazar* project, and the demise of *Qualifyer*. Each time, *Swissair*, ignoring its tiny homemarket, the unfavorable location and limited growth potential of its Zurich hub, and Switzerland's exclusion from the EU aviation market, nevertheless demanded to take on the role of the respective alliances' undisputed leader – a stance, as history has repeatedly shown, not tolerated by its partners for too long. Given this prevalent attitude both among the company's board and its top management, it is not surprising, however, that the more sensible alternative to secure the carrier's long-term survival – to join one of the big three alliances as a major feeder – never was seriously considered as a vital strategic option.

Table 6: Profits/(losses) from associated undertakings (in million CHF)

	1999	2000
Sabena	35	(51)
AOM	(104)	(237)
Air Littoral	(31)	(3)
LTU (<i>Charter</i>)	(167)	(498)
Volare Group (<i>Charter</i>)	(134)	(30)
South African Airways	n/a	16
LOT	n/a	7
Cargolux (<i>Cargo</i>)	20	12
Total for SAirLines companies	(401)	(796)

Source: SAirGroup (the holding company) (2001: 18).

***Swissair* vs. *Crossair*: Competition Instead of Cooperation and Integration**

Crossair was founded in Basle on November 28th, 1978, by *Moritz Suter*, a *Swissair* pilot.²² From 1982, the regional carrier, aside from building its own network from its Basle hub, began serving some thinner routes on behalf of *Swissair*. In 1988 *Swissair* acquired a minority stake of 41 per cent of the voting rights in the *Crossair* – a voting majority for *Swissair* resulted in 1991 –, which had exhausted most of its resources during its expansion. As a result, more and more routes were transferred to *Crossair*, enabling it to realize a load factor of 53 per cent (as opposed to only 40 per cent without the feed traffic). In 1998, in parallel with but operationally unrelated to *Swissair's* “Hunter strategy” *Crossair* – by then by far the largest regional airline in Europe – began to implement its *Eurocross* strategy, by rapidly adding a significant number of

²² See *Lüchinger* (2001: 102ff.).

aircraft to its fleet to build its Basle base into a large-scale regional hub airport, serving 71 European destinations in 2000 (up from 39 *Crossair* destinations in 1990).

In our view, the *SAirGroup*'s top management's failure to coordinate the operations of its regional feeder *Crossair* – of which it owned 70 per cent in fall 2001 – effectively with *Swissair*'s own was the second key factor in the latter's demise. The inefficiency of the *SAirGroup*'s two-hub-strategy in Switzerland cannot only be shown theoretically, using the economic theory of networks.²³ Unlike all its main competitors (*Lufthansa*, *Austrian Airlines*, *British Airways* etc.), that succeeded to do so, *Swissair*, however, allowed *Crossair* a largely stand-alone operation in general – as regards maintenance, sales and marketing, ground handling, IT, to name just a few areas – and to establish a geographically separate hub at its Basle homebase in particular. If anything, this cannibalization on the small Swiss homemarket only resulted in much lower load factors and revenues (yields) for both carriers due to their failure to fully exploit the potential economies of density and large scale of a joint operation.

Contributing Factors

Despite all the shortcomings of *Swissair*'s ultimately disastrous strategy described in the preceding chapters, we doubt that it would have been possible for the company to pursue it for so long if some contributing factors had not come into play. Of particular importance were:

- The negative outcome of the 1992 referendum on Switzerland's accession to the European Economic Area which, as already discussed in more detail above, at least indirectly led to the ill-advised "hunter strategy".
- The Swiss government's long-standing protectionist aviation policy for the benefit of its flag carrier *Swissair* not only enabled the latter to expand into a size not warranted by its rather small homemarket. *Lufthansa* German airlines' long-range fleet, for example, was only slightly more than twice as large as *Swissair*'s before its collapse – with the German carrier's homemarket of 80 mio. being more than 11 times bigger than *Swissair*'s national catchment area.²⁴ Moreover, it is highly likely that both *Swissair*'s hubris and hence its ill-conceived alliance strategy would not have stood the market test for long in a fully liberalized aviation market²⁵ – *Lüchinger*²⁶ argued that with the financial resources spent, or rather wasted on *Qualiflyer*, *Swissair* would have been able to acquire a 20 per cent stake in *British Airways* (before 9/11) alternatively, thereby having established itself firmly in a much more competitive and promising alliance.

²³ For details see *Wojahn* (2001).

²⁴ See *Moser* (2001: 155).

²⁵ See *Schweizer Ökonomeprofessoren* (2001); *Frey* (2001).

²⁶ See *Lüchinger* (2001: 199).

- Uncritical media coverage: Until the mid-1990ies all Swiss journalists obtained a discount of 25 per cent for all their intercontinental and of 50 per cent for all their intraEuropean travel on *Swissair* – regardless of whether the trip had a professional or private background, and subject to no restrictions whatsoever. While *Swissair* did not discriminate amongst beneficiaries on the basis of their actual coverage of the company – critical or uncritical –, this long-standing policy, to say the least, created strong incentives for most Swiss journalists to exclusively rely upon *Swissair* for all their travel needs. Aside from a rather tame coverage of the *SAirGroup*'s strategy in general – at least, if compared to the media reports on airlines in most EU countries or in the USA – this ignorance of the quality standards of other airlines, however, may have led many of them to – wrongly – believe that *Swissair* was still as invulnerable to competitive threats from other airlines as it used to be in its much more successful earlier years.

Outlook

On March 31st, 2002, after several months of intense behind-the-scenes-negotiations between the Swiss government and the country's major companies to determine its size, structure and strategy, and helped by a huge financial start-up package, the *SAirGroup*'s commercial – though not legal – successor *SWISS* began operations as Switzerland's new flag carrier. Built around the *Crossair* nucleus – which immediately before the *Nachlassstundung* was taken over by two major Swiss banks – and its fleet of (then) 82 regional aircraft), it was complemented by 26 of *Swissair*'s long-range and 26 medium-range aircraft as well as the corresponding number of intra-European and intercontinental routes (the so-called 26/26/82-formula). As its two predecessors, it has tried ever since to position itself in the premium segment.

Today, only 16 months later, *SWISS*, too, is on the verge of collapse. Not only did both its fleet and its route network turn out to be substantially oversized, resulting in a total loss of slightly less than Sfr. 1 bn. (\approx € 650 mio.) – including an operating loss to the order of Sfr. 658 mio. – for its first full year in business.²⁷ After some earlier cutbacks – when about one tenth of the fleet was grounded and ten percent of the staff were laid off – proved fruitless, André Dosé, *SWISS*' CEO, announced a massive downsizing at the end of June 2003. Both the number of aircraft in service and the workforce will be cut by one third, and the number of destinations served will be reduced by one fourth.²⁸ Finally, despite a strong management commitment to join, *SWISS* has so far been shunned by the major airlines alliances.

Being, in short, just a slightly shrunk version of *Swissair*, *SWISS*' ongoing troubles do not come as a surprise, however. Moreover, the former *Swissair* staff taken over by the new company have been extremely reluctant to accept wage cuts to align their pay with the much lower wages of their former *Crossair* colleagues. A two-tier wage structure

²⁷ See *Neue Zürcher Zeitung* (2003a).

²⁸ See *Flottau* (2003); *Neue Zürcher Zeitung* (2003b).

and tense labor relations are the result. Finally, *SWISS*' decision to focus on the high-yield segment of the market – although understandable given the company's cost structure – will very likely prove unsustainable in the face of the growing number of low-fare no-frills carriers it has to compete with head-to-head on the Swiss market (easyJet, Germanwings, Air Berlin) – even for business travelers which have become much more price-sensitive in the past few years. *SWISS*' future looks bleak indeed.

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